PUBLIC VERSION

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In the Matter of	)	
DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS AND EPHEMERAL RECORDINGS FOR A NEW SUBSCRIPTION SERVICE	)	**Docket No. 2005-5 CRB DTNSRA**

WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC.

Volume 4 of 6
Designated Testimony from 2005-1 CRB DTRA:
Exhibits to Oral Testimony of Michael Pelcovits

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Written Direct Statement of SoundExchange, Inc.
Volume 4 of 6: Designated Testimony from 2005-1 CRB DTRA: Exhibits to Oral Testimony of Michael Pelcovits

Exhibits to Oral Testimony Admitted into Evidence

- Services Exhibit 51: European Commission decision re Sony/BMG Merger-- No. 4064/89 Merger Procedure (July 19, 2004)
- Services Exhibit 60: Article: "Estimating the Demand for Record Albums," by Alexander Belinfante and Reuben R. Davis, Jr.
- Services Exhibit 62: Arbitron/Edison Media Research report "Internet 9: The Media and Entertainment World of Online Consumers" (2002)
- Services Exhibit 63: Attachment A -- List of License Agreements considered by Pelcovits, including Licensor, Licensee, and Production date information (RESTRICTED)
- Services Exhibit 66: Federal Trade Commission Release -- FTC Closes Investigation of Joint Venture Between Bertelsmann AG and Sony Corporation of America (July 28, 2004)
- Services Exhibit 67: Letter to Joseph Kattan, Esq. from FTC representative Bernard A. Nigro re: The proposed joint venture of Sony Corporation of America and Bertelsmann AG
- Services Exhibit 68: Letter to James F. Rill, Esq. from FTC representative Bernard A. Nigro re: The proposed joint venture of Sony Corporation of America and Bertelsmann AG
- Services Exhibit 69: Statement of Commissioner Mozelle W. Thompson re: Sony Corporation of America/Bertelsmann Music Group Joint Venture
  Services Exhibit 70: Global Competition Review -- An Extract from the 2005 Handbook of Competition Economics Article (June 2005)

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EN

Case No COMP/M.3333 – Sony/BMG

Only the English text is authentic.

REGULATION (EEC) No 4064/89

MERGER PROCEDURE

Article 8 (2)

Date: 19/07/2004

SERV-D-X 51

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 19-07-2004

C(2004) 2815

PUBLIC VERSION

COMMISSION DECISION

of 19 July 2004

declaring a concentration to be compatible with the common market and the functioning of the EEA Agreement

(Case No COMP/M. 3333 – Sony/BMG)

Commission Decision

of 19 July 2004

declaring a concentration to be compatible with the common market

and the functioning of the EEA Agreement

(Case No COMP/M. 3333 – Sony/BMG)

(Only the English text is authentic)

(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Agreement on the European Economic Area, and in particular Article 57 thereof,

Having regard to Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings[1], and in particular, Article 26(2) thereof,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings[2], and in particular Article 8(2) thereof,

Having regard to the Commission's decision of 12 February 2004 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

After consulting the Advisory Committee on Concentrations[3],

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1 OJ L 24, 29.1.2004, p.1.

2 OJ L 395, 30.12.1989, p. 1; corrected version OJ L 257, 21.9.1990, p. 13. Regulation as last amended by Regulation (EC) No 1310/97 (OJ L 180, 9.7.1997, p. 1).

3 OJ C ...,...200., p....

Having regard to the final report of the Hearing Officer in this case[4],

WHEREAS:

(1) On 9 January 2004 the Commission received a notification pursuant to Article 4 of Regulation (EEC) No 4064/89 ("the Merger Regulation"), of a proposed concentration by which the undertakings Bertelsmann AG ("Bertelsmann") and Sony Corporation of America belonging to the Sony group ("Sony", Japan) merge their global recorded music businesses. Bertelsmann and Sony are collectively referred to as "the Parties".

(2) By decision dated 12 February 2004, the Commission found that the notified operation raised serious doubts as to its compatibility with the common market and the functioning of the EEA Agreement. The Commission accordingly initiated proceedings in this case pursuant to Article 6 (1) (c) of the Merger Regulation.

I. THE PARTIES

(3) Bertelsmann is an international media company; its world-wide activities include music recording and publishing, television, radio, book publishing, magazines and newspapers, print and media services, book and music clubs. Bertelsmann is active in recorded music through its wholly owned subsidiary Bertelsmann Music Group, "BMG". BMG's record labels include Arista Records, Jive Records, Zomba and RCA.

(4) Sony is globally active in music recording and publishing, industrial and consumer electronics, and entertainment. In recorded music it acts through Sony Music Entertainment. Sony's labels include Columbia Records Group, Epic Records Group and Sony Classical.

II. THE CONCENTRATION

(5) The proposed operation consists of the contribution of the global recorded music businesses of the Parties (excluding Sony's activities in Japan) into three or more newly created companies pursuant to a Business Contribution Agreement dated 11 December 2003. In the aggregate, these joint venture companies shall be operated under the name SonyBMG.

(6) Sony BMG will be active in the discovery and the development of artists (so-called A&R[5]) and the subsequent marketing and sale of recorded music. Sony BMG will not engage in related activities such as music publishing, manufacturing and distribution.

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4 OJ C ...,...200., p....

5 A&R = Artist and Repertoire; the music industry's equivalent of research and development.

(7) The proposed operation constitutes a full function joint venture. The operation, therefore, gives rise to a concentration within the meaning of Article 3(1)(b), 3(2) of the Merger Regulation.

III. COMMUNITY DIMENSION

(8) The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 000 million (Sony: EUR 62,519 million; Bertelsmann: EUR 18,312 million)[6]. The aggregate Community-wide turnover of both Sony and Bertelsmann is more than EUR 250 million (Sony: [...]* million; Bertelsmann: EUR [...]* million), and they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

IV. RELEVANT MARKETS

A.Recorded Music

Relevant product market

(9) The Parties consider the relevant product market to be the market for all types of recorded music (i.e. "A&R" and the promotion, sales and marketing of recorded music). The Parties have also submitted market share data for the categories international pop, local pop, classical music and compilations, but do not consider a subdivision meaningful, indicating that competition does not take place exclusively in genres or in other possible segmentations. In addition, the Parties point out that there are no accepted industry standards of genres, and that musical tastes are developing constantly, resulting in changing preferences for genres. As regards compilations, the Parties indicate that there is direct competition between compilations and single artist recordings (including "best of" tracks from a single artist) and as such a distinction is considered of little relevance to market definition.

(10) The Commission previously investigated the market for music recording in *Thorn EMI/Virgin Music*[7] and observed that the central activity of record companies was the selling of records, encompassing the signing up, recording and promotion of artists. Furthermore, there were indications that the market for music recording could be broadly divided into the categories popular music ("pop") and classical music.

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6 Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C 66, 2.3.1998, p. 25).

* Parts of this text have been edited to ensure that confidential information is not disclosed; those parts are enclosed in square brackets and marked with an asterisk.

7 Case No IV/M.202 – Thorn EMI/Virgin Music, Commission decision of 27 April 1992.

(11) In *Seagram/Polygram*[8] the Commission assessed the impact of the merger on the market for music recording and distribution. The Commission specified that record companies discover and develop artists, record music, organise manufacturing and distribute, market and promote record releases. Regarding the distinction between national and international pop, the Commission considered that some pop music is only marketed nationally and therefore possibly represents a distinct product market. The Commission also noted that within pop music a large number of different categories could be identified (for example, jazz, soul, heavy metal and techno), possibly constituting distinct product markets as well.

(12) The results from the market investigation have shown that, from a demand side perspective, end consumers make purchasing decisions based on a number of criteria such as type of music (genre), individual artist or single versus album. Also, promotional campaigns appear to have a significant effect on their purchasing behaviour. From the supply side, record companies may sign artists and sell records across a range of different genres. Independents labels, however, often specialise in certain specific genres. The Commission considers that, for the purpose of this case, it is not necessary to decide whether distinct product markets based on genre exist and whether there is a distinct product market for compilations.[9]

(13) In this case, it is however not necessary to decide whether the various genres or categories constitute separate markets as, whatever the market definition considered, no creation or strengthening of a dominant position arises.

Relevant geographic market

(14) The Parties are of the opinion that the relevant geographic market for music recording is national. In support of this they submit that pricing (including discounts) and the sale of recorded music are carried out predominantly on a national scale. Furthermore, there is a strong local artist demand in all Member States and, in addition, A&R is to some extent a local business. The Parties also point out that only a few major customers have an international presence, marketing mainly takes place nationally and the shares of different record companies vary from Member State to Member State. In addition, many independent record companies are only present in one or a few Member States.

(15) In previous decisions the Commission found that the relevant geographic market has both national and international characteristics, but left the exact scope of the geographic market open. The results from the market investigation provide several indications for national markets, namely the organisation of record companies on a national level as well as differences in consumer preferences and price levels. For the purpose of this case, the relevant geographic markets are therefore considered to be national.

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8 Case No IV/M.1219 – Seagram/Polygram, Commission decision of 21 September 1998.

9 See also Case No COMP/M.2883 – Bertelsmann/Zomba, Commission decision of 2 September 2002.

B. Online Music Markets

(16) Increasingly music is sold and distributed to the end user over the Internet by means of downloading or streaming of digital music files. Third parties have confirmed the emergence of this market, but some of them have predicted that revenues in the next two to three years will remain only limited. However, on the basis of a market research study, other third parties expect that online music will represent up to 30 % of the total music market in 2008[10]. The market investigation also indicates that online distribution of music will only partly replace physical distribution of music (CDs) but will also create incremental or complementary demand.[11] Despite the relatively unsuccessful attempts of record companies to develop a market for paid-for online music in the past years, there have been strong signals of a quick development of the paid-for music downloading, in particular with the success of Apple's iTunes in the US and its launch in Europe in June 2004.

(17) In the EEA, there are currently a number of players active in the online provision of music. For instance, HMV, Virgin Megastores and MSN Microsoft are active in the United Kingdom, T-Online Musicload, AOL Music Store, Karstadt, MediaMarkt and Phonoline are active in Germany, E-compil (a subsidiary of Universal), FNAC and VIRGINMEGA are active in France, and Skynet (a subsidiary of Belgacom) is active in Belgium. The Internet provider Tiscali is active in Italy, United Kingdom, France, Germany, Netherlands, Spain and Belgium.

(18) A number of players further announced that they would start their music online service in the current year 2004. Apple launched its European version of the iTunes music store in June 2004, and Sony followed with its European Sony Connect service in July 2004.

(19) Several business models have evolved in the field of online music, in particular downloading and streaming of online music. The main difference between downloading and streaming is that downloading allows the downloaded music to be permanently stored on the user's computer, transferred to other devices (in particular portable music players) and burnt on CDs whereas in case of streaming the audio file is only temporarily transferred to the user's computer. The most successful legal "à-la-carte download" model currently seems to be operated by Apple's iTunes music service with 70 million tracks sold from April 2003 to April 2004 in the US, and 800,000 tracks sold during the first week of its operation in France, Germany and the United Kingdom in June 2004. Streaming appears to be used, on the one hand, by downloading services in order to enable users to pre-listen to portions of songs. On the other hand, online music services

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10 Reference was made to the Forrester online study.

11 Incremental demand is for example expected from innovative music services, from additional "sales locations" (e.g. web portals, online retailers, mobile portals etc.), and from customer groups who currently use illegal downloads but are willing to pay for legal downloads as soon as those fulfil their requirements, namely access to a broad offer of individually downloadable tracks.

have been established which offer unlimited streaming of music against payment of a subscription fee, such as Rhapsody in the U.S. and FNAC in France (offering both downloading and streaming).

(20) There are further differences in the level of services which are provided by the operator of the online music service. Whereas some of them operate their own platform (mostly with the help of some technical service providers) and have entered into the necessary agreements with the right holders, some others are using the services of providers to operate the online platforms for them. The most developed of such platforms in Europe appears to be OD2 which provides the technical infrastructure for the downloading of music and has obtained licences from the record labels to sell the music catalogue digitally. OD2 has been the most successful online music platform so far. OD2 operates in two different ways: (1) it provides and sells downloads directly to end-consumers; (2) it resells the licensed music catalogues to third parties which then offer the downloading service on their own website ("white label wholesale offer"). The website owners either receive a commission payment on the transactions, if the online music service is operated by OD2, or they pay OD2 for the licences, if they operate the music downloading service themselves. Distribution partners of OD2, *inter alia*, are HMV (for United Kingdom and Ireland), Belgacom (for its Belgian ADSL customers), Tiscali (for Italy, United Kingdom, France, Germany, Netherlands, Spain and Belgium), Microsoft MSN (for the United Kingdom, MTV for Germany, France, Italy, Spain and the Netherlands), and Wanadoo and FNAC for France. A further example of such a wholesale offer is the recently launched "Phonoline" in Germany, a technical platform set up by the German record industry in order to facilitate the licensing.

Relevant product markets

(21) According to the Parties in the notification both online delivery and distribution through physical media remain, at this stage, two methods of distributing the same product: recorded music. The Parties therefore consider that there are no grounds to define online digital music as a separate product market from physical formats and are of the opinion that the market for online music forms part of the larger market for recorded music.

(22) In previous decisions, the Commission came to the conclusion that there is an emerging but separate market for the online delivery of music, including streaming and downloading of music[12]. In this case, the market investigation has confirmed that online music is not part of the general market for recorded music as there are significant differences between the distribution of recorded music via physical carrier and its online sale.

(23) As also the Parties acknowledge, when purchasing a CD, a consumer currently acquires an entire album, whilst customers of online downloading services focus

[12] See Cases No COMP/M.2050 – Vivendi/Canal+/Seagram, Commission decision of 13 October 2000; No COMP/M.1845 – AOL/Time Warner, Commission decision of 11.10.2000, OJ L268, 9.10.2001, p 28; No COMP/JV.25 - Sony/Time Warner/CDNow, Commission decision of 21 December 1999.

on individual tracks rather than on albums and create their own play lists. The market investigation confirmed that the downloaded product therefore is different from the traditional product, the CD. In particular, online customers often wish to create their own albums with selected tracks from different albums. Further from the demand side, consumers can buy music from any computer with Internet access, instead of having to visit a store, and need special software to play the music they have downloaded. The online music market may also support business models that are considerably different from the sale of physical CDs. Downloading of music is the way of acquiring online music most similar to the purchase of CDs, whereas streaming only allows a temporary storage of the music, not comparable to the purchase of a traditional CD. In the online market, record companies also have more control over the rights consumers can exercise over the music. Once the consumer has bought a CD, music labels do not have much ability to control how the product is used.[13] In the case of online music, however, the record companies can enforce rules regarding transfer, play and downloading of the music via the digital rights management ("DRM"). From the supply side, the structure of online distribution of downloadable music is completely different from the physical distribution of music both in bricks and mortar shops and e-commerce. This is also true for the position of the record companies themselves. For the sales of CDs, record companies have to procure the production and distribution of a physical product and incur the corresponding costs (raw material costs, packaging, inventory storage, shipping, risk of obsolescence, etc.). In the online market, they basically have to grant licences to online services providers.

(24) On the basis of the foregoing the Commission considers that online music is not part of the market for physical recorded music. In online music, two different markets must be distinguished: (1) The wholesale market for licences for online music and (2) the retail market for distribution of online music.

Wholesale market for licences for online music

(25) An online music service, irrespective of whether this service offers streaming or downloading of online music or both, needs the consent of the record labels to offer music online for downloading or streaming. Depending on the applicable intellectual property legislation, sound recordings are protected either as copyrights of the record companies themselves or as neighbouring rights of the performing artists (singers etc.) who regularly assign them to their record companies under the terms of their recording agreements. For streaming, the provider of the online music service only needs the right for the communication to the public, whereas for downloading of online music the provider needs, in addition, the right to copy the sound recordings concerned. An offer of online music without such licences would be illegal and constitute an infringement of intellectual property rights.

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13 The Commission acknowledges, however, the existence of copy protection systems.

(26) Online music service providers also need to obtain licences from the holders of the publishing rights,[14] i.e. from authors and composers and/or their publishers which are normally obtained via the (national) collecting societies. The licensing of publishing rights therefore involves publishers and/or collecting societies on the supply side, and online music service providers on the demand side.[15] It is therefore not part of the market at stake in which, on the supply side, record companies license the performing artists' copyrights (which are assigned to them) and/or their own rights, and the online music service providers are on the demand side.

(27) The market investigation has confirmed that there is an emerging wholesale market for the granting of licences for online music by the record companies to the providers of online services. It can be left open whether the granting of licences for music downloading and of licences for streaming constitutes one or separate markets as the final assessment of the case is the same.

Retail market for online distribution of music

(28) A further separate market is the retail market for the delivery of online music to the end-consumer by offering downloading and streaming of music. Suppliers in this market are the operators of online music services, which offer downloading and/or streaming. The most successful online music services currently appear to be Apple's iTunes and RealNetwork's Rhapsody services. However, Apple only started its operations in the EEA in June 2004; RealNetwork's activities are currently limited to the US, and it only intends to enter the European markets. Some downloading services are also operated by the record labels themselves, such as E-compil in France, a subsidiary of Universal, and Sony Connect, a subsidiary of Sony.

(29) The market investigation confirmed that there is an emerging retail market for the distribution of online music via the Internet to end-consumers. For the purpose of this assessment it can be left open whether online downloading and streaming are part of the same market for the distribution of online music or whether they form separate markets. The competitive assessment is the same under any market definition considered.

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[14] It depends on the type of online service offered what bundle of publishing rights will be required. As online distribution implies reproduction as well as public performance, an online music service generally needs licences for both mechanical rights and performance rights relating to the musical works.

[15] The Commission acknowledges that some record companies also invoice royalties for publishing rights to online music service providers. However, in these cases record companies act as mere "collectors" for the (Publishing) Collecting Societies (partly, without being mandated by them) and do not determine the royalty rates due by the online music service providers.

Relevant geographic markets

Wholesale market for licences for online music

(30) Despite the inherent cross-border nature of the Internet, the licences for online music are currently granted on a national basis only. It results from the market investigation that the licensing agreements between record companies and online music service providers contain territorial restrictions to a single country. These licensing agreements normally cover only one country and oblige the online music service providers to warrant that their customers are residents of that country and that non-residents are unable to use the services provided.

(31) The Commission found indications that, even if the service of an online music provider covers several countries, the licensing agreements focus on the national licences and may differ in their content, in particular in terms of pricing and usage rules. In addition, contractual provisions foresee that the specific country website must only offer online music to the residents in that country.

(32) For the purpose of the current investigation, the Commission therefore considers the wholesale market for online licences as national in scope. However, this may change in the future, in particular if cross-border contractual arrangements for licensing develop.

Retail market for online distribution of music

(33) As regards the geographic scope of the retail market for online distribution of music, the Commission has previously considered that the possibilities offered by digital technology imply a geographic market that extends beyond national borders and which could be at least EEA-wide[16]. Despite this previous finding which related to the online market in a very early stage, it results from the market investigation in this case that the online markets are currently still national in scope.

(34) Due to the national scope of their licences, most online music providers currently only offer their services on a national basis. The provider OD2 may be considered an exception as this provider has been able to secure licences for several Member States. However, even this provider works with different websites for different countries, in particular on the basis of its wholesale model. Similarly, Apple might be considered as an exception; however, also Apple operates different web sites for its activities in the United Kingdom, France and Germany, and applies different rates in the United Kingdom.

(35) Furthermore, the licences agreements oblige the online music providers to warrant that their customers are residents of a specific country. The online music service provider has to request its customers to register and has to verify that the payment is made from a domestic bank account. According to the agreements, the online music service provider is further prohibited from promoting its platform abroad or in foreign languages. Consequently, online service providers offer

[16] See Case No COMP/M.1845 – AOL/Time Warner.

different language versions. For instance, Tiscali offers different language versions of its music club for France, Italy, United Kingdom, Germany, Spain, and the Netherlands (all versions are operated by OD2).

(36) Given the above, the Commission currently considers that also the retail market for distribution of online music to be national in scope. This may also change in the future if cross-border contractual arrangements for licensing develop and pan-European online music platforms emerge.

C. Music publishing

Relevant product markets

(37) The markets for music publishing are located upstream to the markets for recorded music and for online distribution as music publishing rights constitute necessary inputs for music recording and (retail) distribution of online music. In order to illustrate the articulations between the different product markets, the following recitals describe the different parties involved in the production of a recording. At the origin of a musical work are its author(s) and composer(s) who create the lyrics and the melody. In order to exploit their rights to this work authors and composers will either register ownership with a collecting society or assign their rights to a music publisher who then retains a share of the revenues in return for assistance in promoting the work.

(38) For any sound recording of the musical work a record company needs a (usually non-exclusive) licence for the *mechanical rights* to the music, which must be obtained from the right holder, i.e. the author, composer or publisher, in return for the payment of a royalty. Mechanical rights collecting societies collect revenues from the exploitation of the mechanical rights and distribute the revenue to the right owners. With a licence for these mechanical rights a record company is entitled to use the work for recording (with a singer) and the subsequent manufacturing, marketing and distribution of the record.

(39) For broadcasting via radio and television or for live performances in a concert or in public places such as restaurants and discotheques, the user needs to obtain the *performance rights* relating to the work. Performance rights collecting societies administer these rights and conclude agreements with right users (for example radio/TV broadcasting stations), collect the revenues and make distributions to the right holders. Mechanical rights and performance rights are in many countries (for example France, Germany, Italy, Spain, United Kingdom) collected by the same collecting society but in some countries there are separate societies (for example Scandinavian countries). Other publishing rights are *synchronisation rights* (use of a music works in an audio-visual works such as a movie) and *print rights* (also known as graphic rights) for the use of sheet music. Collecting societies are regularly not involved in the administration of these rights and agreements are usually concluded directly between the publisher or author/composer and the user (for example a film production company).

(40) Music publishing consists mainly of the acquisition by publishers of rights to musical works and their subsequent exploitation upon remuneration, mostly in the

form of a commission charged by the publisher to the author (lyricist and/or composer) on the revenues generated by the commercial exploitation of musical works. The main activities of a music publisher are (a) the discovery of authors and composers, (b) artistic and financial support to authors and composers, (c) legal protection of the musical work, (d) commercial exploitation of the musical work and (e) administration of the authors' and composers' patrimonial rights. Publishers derive revenues from the commercial exploitation of musical works, be it reproduction-based exploitation (mechanical and synchronisation rights), performance-based exploitation (performing rights) or distribution-based exploitation (printing rights). The recording business is different from music publishing, as it focuses on the discovery and development of artists who perform the musical works (i.e. singers and musicians) and the promotion, marketing and sale of sound recordings.

(41) The Parties are of the opinion that there is one overall music publishing market, without any distinction as to the type of publishing right (i.e. mechanical, performance, synchronisation, print and other rights). In the Parties' view such a distinction would not correspond to the commercial reality of the industry where publishers normally acquire and commercialise all types of rights in respect of a certain composition or lyrics.

(42) In its *Seagram/Polygram* decision, the Commission stated that the exploitation according to the different kinds of rights may lead to the definition of separate product markets for each of the categories of rights, although it left open the precise product market definition. There are some indications for the existence of separate product markets for music publishing according to the exploitation of the different categories of rights, namely mechanical, performance, synchronisation and printing, on the basis of both demand-side considerations (the different types of rights present different characteristics and relate to different customer needs, the licensing of one type of right not being a substitute for the licensing of another) and supply-side considerations (existence of different exploitation systems, application of dissimilar licensing rates, and considerable differences in the commercial and financial importance of the different rights for the publisher).

(43) However, the exact scope of the relevant product market can be left open as the competitive assessment is the same under any market definition considered.

Relevant geographic market

(44) The Parties consider the geographic scope of the market to be essentially national, bearing in mind that licence fees for mechanical and performance rights are generally collected on a national basis.

(45) In previous cases the Commission has left open whether the geographical scope of the music publishing markets is national or broader, in particular EEA-wide[17]. Regarding mechanical and performance rights, several elements point in the direction of national markets, in particular the fact that they are generally

[17] Cases No IV/M.202 - Thorn EMI/Virgin Music and No IV/M.1219 - Seagram/Polygram.

administered and collected by the national collecting societies on behalf of the publishers and/or authors/composers. Moreover, the level of royalties for performance rights is negotiated on a national basis through the local collecting societies and therefore varies across the Community. As for mechanical rights, there are certain indications that the market may be wider than national, in particular as regards cross-licensing arrangements among collecting societies which allow for licensing through a single collecting society for the whole of the EEA, and the so-called Standard Agreement between the Bureau International des Sociétés Gérant les Droits d'Enregistrement et de Reproduction Mécanique (BIEM), on behalf of the collecting societies, and the International Federation of the Phonographic Industry (IFPI), on behalf of the record companies, regarding the royalty rates for the exploitation of mechanical rights. However, in spite of these cross-border elements, the underlying rights are still administered and monitored on a national basis. The exact scope of the relevant geographic market can be left open as the competitive assessment is the same under any market definition considered.

V. COMPATIBILITY WITH THE COMMON MARKET AND THE EEA AGREEMENT

A. Recorded Music

I. MARKET STRUCTURE

(46) The markets for recorded music in all EEA countries are characterised by the presence of five world-wide active record companies (hereinafter, "the majors") and a large number of significantly smaller record companies (hereinafter, "the independents"). The Parties have provided estimated market shares of the majors regarding each EEA country[18] for 2001 - 2003, which are set out in the tables 1 – 3 below. Market share data for 2003 was submitted by the Parties on 21 June 2004; data on individual independents has not yet been available.[19]

Table 1:

Market shares majors 2001									
Territory	Total Market Value (€)	BMG	SMEI	*Combined*	UMG	WMG	EMI	Others	*Total*
Austria	140,400,000	[10-15%]*	[10-15%]*	*[20-25%]**	[20-25%]*	[10-15%]*	[15-20%]*	[25-30%]*	*100*
Belgium/ Luxembourg	169,600,000	[5-10%]*	[10-15%]*	*[20-25%]**	[25-30%]*	[10-15%]*	[15-20%]*	[15-20%]*	*100*
Denmark	129,423,000	[5-10%]*	[10-15%]*	*[20-25%]**	[20-25%]*	[10-15%]*	[30-35%]*	[10-15%]*	*100*
Finland	79,200,000	[10-15%]*	[5-10%]*	*[15-20%]**	[10-15%]*	[15-20%]*	[10-15%]*	[40-45%]*	*100*
France	1,274,500,000	[5-10%]*	[15-20%]*	*[20-25%]**	[30-35%]*	[5-10%]*	[20-25%]*	[10-15%]*	*100*
Germany	1,554,700,000	[15-20%]*	[10-15%]*	*[25-30%]**	[25-30%]*	[10-15%]*	[10-15%]*	[20-25%]*	*100*
Greece	59,000,000	[5-10%]*	[15-20%]*	*[20-25%]**	[15-20%]*	[5-10%]*	[30-35%]*	[20-25%]*	*100*
Ireland	87,100,000	[10-15%]*	[15-20%]*	*[30-35%]**	[35-40%]*	[10-15%]*	[15-20%]*	[0-5%]*	*100*
Italy	378,300,000	[10-15%]*	[10-15%]*	*[25-30%]**	[25-30%*]	[15-20%]*	[15-20%]*	[5-10%]*	*100*
Netherlands	279,500,000	[10-15%]*	[15-20%]*	*[25-30%]**	[25-30%]*	[10-15%]*	[15-20%]*	[15-20%]*	*100*
Norway	127,106,000	[5-10%]*	[10-15%]*	*[20-25%]**	[20-25%]*	[5-10%]*	[20-25%]*	[20-25%]*	*100*
Portugal	106,338,000	[5-10%]*	[10-15%]*	*[15-20%]**	[20-25%]*	[10-15%]*	[15-20%]*	[30-35%]*	*100*
Spain	458,300,000	[10-15%]*	[10-15%]*	*[20-25%]**	[15-20%]*	[15-20%]*	[15-20%]*	[25-30%]*	*100*
Sweden	197,279,000	[10-15%]*	[10-15%]*	*[20-25%]**	[20-25%]*	[10-15%]*	[25-30%]*	[15-20%]*	*100*
UK	1,980,707,000	[10-15%]*	[10-15%]*	*[20-25%]**	[25-30%]*	[10-15%]*	[20-25%]*	[15-20%]*	*100*
Total	*7,021,453,000*	[10-15%]*	[10-15%]*	*[20-25%]**	[25-30%]*	[10-15%]*	[15-20%]*	[15-20%]*	*100*
Source: Notifying Parties; using IFPI Data, BMG Data, and Music&Copyright Data for third parties									

[18] EEA in this context refers only to the 18 Member States at the time of notification of the concentration.

[19] The Parties explain in the notification: "Shares for BMG and SMEI are based on their 'owned content' sales reported to IFPI and IFPI total market sizes. Shares for other major record companies are based on Music & Copyright. In 2002, Music & *Copyright* changed its method of calculating market shares to reflect only owned content. The figures for 2000-2001 show figures based on both owned and distributed content, *i.e.*, majors' shares include share properly attributable to distributed labels. Direct comparison between 2002 figures on the one hand and 2000-2001 figures on the other is therefore not possible. Shares for independents are not readily available and are based on Parties' estimates based on data from BPI and *Understanding & Solutions*, apart from the 'total independents' figure, which is a function of the majors' shares".

Table 2:

Market shares Majors 2002									
Territory	Total Market Value (€)	BMG	SMEI	*Combined*	UMG	WMG	EMI	Others	*Total*
Austria	126,400,000	[10-15%]*	[10-15%]*	*[20-25%]**	[25-30%]*	[10-15%]*	[15-20%]*	[25-30%]*	***100***
Belgium/ Luxembourg	153,000,000	[5-10%]*	[10-15%]*	*[20-25%]**	[25-30%]*	[5-10%]*	[15-20%]*	[20-25%]*	***100***
Denmark	109,000,000	[5-10%]*	[15-20%]*	*[20-25%]**	[25-30%]*	[5-10%]*	[25-30%]*	[10-15%]*	***100***
Finland	73,300,000	[10-15%]*	[10-15%]*	*[20-25%]**	[15-20%]*	[10-15%]*	[20-25%]*	[20-25%]*	***100***
France	1,319,900,000	[5-10%]*	[15-20%]*	*[20-25%]**	[30-35%]*	[10-15%]*	[15-20%]*	[10-15%]*	***100***
Germany	1,387,700,000	[10-15%]*	[10-15%]*	*[25-30%]**	[25-30%]*	[10-15%]*	[15-20%]*	[15-20%]*	***100***
Greece	65,600,000	-	[15-20%]*	*[15-20%]**	[15-20%]*	[5-10%]*	[25-30%]*	[30-35%]*	***100***
Ireland	79,700,000	[15-20%]*	[15-20%]*	*[30-35%]**	[20-25%]*	[10-15%]*	[20-25%]*	[10-15%]*	***100***
Italy	380,300,000	[10-15%]*	[10-15%]*	*[25-30%]**	[25-30%]*	[15-20%]*	[15-20%]*	[10-15%]*	***100***
Netherlands	240,300,000	[10-15%]*	[15-20%]*	*[25-30%]**	[20-25%]*	[5-10%]*	[10-15%]*	[20-25%]*	***100***
Norway	142,091,000	[5-10%]*	[10-15%]*	*[20-25%]**	[20-25%]*	[5-10%]*	[15-20%]*	[25-30%]*	***100***
Portugal	108.500.000	[5-10%]*	[10-15%]*	*[15-20%]**	[20-25%]*	[5-10%]*	[15-20%]*	[30-35%]*	***100***
Spain	386,700,000	[10-15%]*	[10-15%]*	*[20-25%]**	[15-20%]*	[15-20%]*	[5-10%]*	[35-40%]*	***100***
Sweden	185,000,000	[10-15%]*	[10-15%]*	*[25-30%]**	[15-20%]*	[10-15%]*	[20-25%]*	[20-25%]*	***100***
UK	1,885,851,000	[10-15%]*	[5-10%]*	*[20-25%]**	[25-30%]*	[5-10%]*	[15-20%]*	[20-25%]*	***100***
Total	***6,643,342,000***	***[10-15%]****	***[10-15%]****	*[20-25%]**	***[25-30%]****	***[10-15%]****	***[15-20%]****	***[20-25%]****	***100***
Source: Notifying Parties; using IFPI Data, BMG Data, and Music&Copyright Data for third parties									

Table 3:

Market shares Majors 2003									
Territory	Total Market Value (€)	BMG	SMEI	*Combined*	UMG	WMG	EMI	Others	*Total*
Austria	124,724,100	[10-15%]*	[5-10%]*	*[15-20%]**	[30-35%]*	[10-15%]*	[15-20%]*	[20-25%]*	***100***
Belgium/ Luxembourg	142,153,800	[10-15%]*	[10-15%]*	*[20-25%]**	[25-30%]*	[5-10%]*	[20-25%]*	[15-20%]*	***100***
Denmark	96,565,800	[5-10%]*	[10-15%]*	*[20-25%]**	[20-25%]*	[10-15%]*	[40-45%]*	[5-10%]*	***100***
Finland	77,764,000	[5-10%]*	[5-10%]*	*[15-20%]**	[15-20%]*	[10-15%]*	[15-20%]*	[35-40%]*	***100***
France	1,175,561,800	[5-10%]*	[15-20%]*	*[25-30%]**	[30-35%]*	[10-15%]*	[15-20%]*	[10-15%]*	***100***
Germany	1,200,458,500	[15-20%]*	[10-15%]*	*[25-30%]**	[20-25%]*	[10-15%]*	[10-15%]*	[20-25%]*	***100***
Greece	59,037,900	-	[10-15%]*	*[10-15%]**	[15-20%]*	[5-10%]*	[35-40%]*	[20-25%]*	***100***
Ireland	70,372,100	[10-15%]*	[15-20%]*	*[30-35%]**	[25-30%]*	[15-20%]*	[20-25%]*	[0-5%]*	***100***
Italy	370,141,100	[15-20%]*	[15-20%]*	*[30-35%]**	[20-25%]*	[15-20%]*	[15-20%]*	[5-10%]*	***100***
Norway	119,109,087	[5-10%]*	[10-15%]*	*[15-20%]**	[20-25%]*	[10-15%]*	[20-25%]*	[25-30%]*	***100***
Netherlands	253,477,400	[10-15%]*	[10-15%]*	*[25-30%]**	[20-25%]*	[5-10%]*	[15-20%]*	[25-30%]*	***100***
Portugal	95,697,500	[5-10%]*	[10-15%]*	*[15-20%]**	[15-20%]*	[5-10%]*	[20-25%]*	[35-40%]*	***100***
Spain	353,541,200	[10-15%]*	[10-15%]*	*[20-25%]**	[15-20%]*	[20-25%]*	[10-15%]*	[25-30%]*	***100***
Sweden	161,555,800	[10-15%]*	[10-15%]*	*[20-25%]**	[15-20%]*	[10-15%]*	[20-25%]*	[20-25%]*	***100***
UK	1,781,959,420	[10-15%]*	[5-10%]*	*[20-25%]**	[25-30%]*	[10-15%]*	[15-20%]*	[15-20%]*	***100***
Total	***6,082,119,507***	***[10-15%]****	***[10-15%]****	*[20-25%]**	***[25-30%]****	***[10-15%]****	***[15-20%]****	***[15-20%]****	***100***
Source: Estimate of the Parties in submission of 21.06.2004									

1. The major recording companies

(47) The five majors account, in most countries,[20] for approximately 72-93% of the market in terms of sales of so-called "owned content"[21], based on a product

20 Except Finland and Portugal where their combined market share is between [60-70%]* and Ireland where their market share is [>90%]*.

21 According to the notification, IFPI defines "Owned Content" as trade sales of finished music product by the Member Company (i.e. the record company) to retailers or to intermediate wholesalers, net of returns and discounts and excluding exports (in accordance with IFPI Market Data Reporting Definitions). The following do not qualify as Owned Content sales: (i) sales by minority owned labels; (ii) sales of finished

market definition comprising all genres of recorded music. In terms of distributed sales, i.e. including records they distribute for independent labels, the majors' market shares are even higher.[22]

(48) On an EEA-wide level and in most Member States, Universal is the largest major with an EEA share of [25-30%]* in 2003 and national market shares ranging from [15-20%]* (Portugal) to [30-35%]* (France). EMI is the second largest major in the EEA with a share of [15-20%]* in 2003, and national market shares ranging from [10-15%]* (Spain) to [40-45%]* (Denmark). Warner's EEA share was [10-15%]* in 2003, with its national market shares ranging from [5-10%]* (Greece) to [20-25%]* (Spain). BMG's EEA share was [10-15%]* in 2003, with its national market shares ranging from [5-10%]* (Portugal) to [15-20%]* (Germany). Sony is currently the smallest major in the EEA with a 2003 share of[10-15%]*, and its national market shares ranging from [5-10%]* (Austria) to [15-20%]* (Ireland). The combined entity would thus have a size comparable to Universal with an EEA share of [20-25%]* in 2003 and its national market shares ranging from [10-15%]* (Greece) to [30-35%]* (Italy).

2. The independents

(49) In the EEA, the independent record companies account altogether for approximately [15-20%]* of the market. There are exceptions, however, where independent labels have been particularly successful, notably in Finland and Portugal, where the independents' reached combined market shares of more than [30-35%]* in 2003.

(50) The independents in the United Kingdom (for example Demon, Ministry of Sound, Sanctuary and V2), Germany (for example Edel), the Netherlands (for example Disky), Sweden (for example Bonnier), Greece, Belgium, Norway, Spain (Vale) and Austria reached market shares in the range of [20-25%]* to [25-30%]* collectively in 2003.

(51) In the remainder of the EEA, notably France (for example Naïve and Wagram), Italy (for example Universo), Denmark and Ireland the combined market shares of the independents range from [0-5%]* to [10-15%]*. On an individual basis, the large majority of independent labels have market shares below 1% on a national level.

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product from distribution deals; (iii) sales of finished music product by Member Company's licensees; (iv) all other forms of revenue that are not wholesale sales or finished music product, e.g. license income fees or royalty based income, etc.

22 In the following, market share data is based on "owned content" unless it refers explicitly to "distributed sales".

3. Characteristics majors - independents

(52) The market investigation has confirmed that the majors and the independents have very different characteristics.

(53) The five majors are characterised by:

- a world-wide presence and therefore a world-wide representation for international artists;
- partly a vertically integrated organisation. Traditionally, majors have been present in all parts of the value chain in music recording: from the signing of artists, the manufacture of CDs, to the distribution to the end consumer. However, recently majors have more focussed on A&R activity and marketing and outsourced in particular manufacturing and distribution (in particular [Major X]*) or have transferred these activities to sister companies within the group (BMG, Arvato).
- besides recording, the majors also have publishing activities and some of them are active on various downstream markets, such as broadcasting and the online exploitation of music.
- significant financial strength, making the major record company less vulnerable to risks and enabling them to offer artists more attractive financial benefits (for example higher advances, much higher promotional and marketing expenditure).
- the large, diversified portfolio of artists they have contracted and the significant back catalogue.

(54) The independents are characterised by:

- a much smaller organisation and the large number of small players present on the market (thousands in the EEA).
- a focus on A&R and recording, more than on the rest of the value chain.
- operations taking place mainly on a national scale, although a limited number of successful independents also have international operations which, however, only cover a limited number of Member States. For international representation of their artists, they need to conclude licensing agreements with majors or other independents.
- not generally having their own manufacture and distribution facilities. For (international) distribution the independents often depend on the distribution networks of the majors. Even those independent record companies which have their own distribution facilities on a national basis rely on the majors' or other independents' international distribution facilities
- a much more limited budget for promotional and marketing expenditure, which makes them less attractive for international artists.
- a frequent focus on a particular repertoire (classical, dance, etc.) or "niche" genres. Independents are less prone to mainstream music.
- a limited access to mass media, in particular radio and TV.

- a dependency on new releases, more than on a large back catalogue.

II. DEVELOPMENT OF DEMAND IN THE MARKETS FOR RECORDED MUSIC

(55) Since 1999, the recorded music industry has faced a decline in sales. According to information submitted by the Parties, unit sales on the wholesale level fell by 13% in the EEA[23] between 1999 and 2002, and by a further 7 % from 2002 to 2003. Demand has decreased very differently in the different countries, as shown in table 4. The French market, after having been the only one to grow during the period 1999-2002, decreased in 2003, whereas the Finnish and British markets grew in 2003 after a decline in the years 1999 to 2002.

Table 4:

	A	B	DK	FIN	F	D	GR	IRL	I	NL	P	E	S	UK	N
1999 – 2002	-29%	-29%	-37%	-10%	+2%	-22%	-6%	-9%	-12%	-23%	-12%	-10%	-5%	-9%	-4%
2002 - 2003	-1%	-9%	-17%	+7%	-9%	-18%	-7%	-10%	-2%	-12%	-7%	-12%	-10%	+6%	-12%

Source: Notification and Parties' submission of 10.05.2004, based on IFPI data.

(56) The parties further submit that the decrease of the sales volume has been accompanied by a decrease of average CD wholesale prices (adjusted for inflation) in most countries.[24] According to the Parties average wholesale prices have decreased in most countries[25] by [10-20%]* from 1997 to 2003, and by even [20-30%]*in Ireland, Portugal, Spain and Sweden whereas they have been relatively stable in Italy and Denmark. However, the Commission's analysis of the data provided by the Parties and the other majors, as set out under III 1, does not confirm these figures. In particular the (inflation adjusted) wholesale price decrease of the majors' top 100 albums appears to have been much lower than suggested by the figures provided by the Parties.

(57) There appear to be a number of reasons for the decrease in demand. According to the Parties, the main reasons are counterfeit CD sales, unauthorised copying and downloading (for example file-sharing or peer-to-peer networks), and the growing importance of DVDs and other entertainment products. However, recent empirical studies suggest that the importance of peer-2-peer downloading might be overestimated as file-sharing downloads "have an effect on sales which is statistically indistinguishable from zero, despite rather precise estimates. Moreover, these estimates are of moderate economic significance and are inconsistent with claims that file sharing is the primary reason for the recent

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23 EEA in this context refers only to the 18 Member States at the time of notification of the concentration.

24 Parties' submission of 10 May 2004, based on IFPI data.

25 Austria, Finland, Netherlands, Belgium, Germany, France, Greece, United Kingdom and Norway.

decline in music sales. At most, file sharing can explain only a tiny fraction of this decline."[26] In any case, the major record companies have started to sue users of illegal download sites, both in the U.S. and, more recently, also in Europe.[27] It is estimated that - due to the dissuasive effect of such litigation - the number of illegal downloaders in the U.S. has decreased by approximately 50% within 6 months.[28] Similar results are expected in the Community, where the legal protection of copyright has been strengthened by Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights[29] and legal actions by the major record companies have been initiated recently, for example in Germany, Italy and Denmark. In addition, the music industry is increasingly using sophisticated copy-protection systems to protect records against counterfeiting.

(58) The Commission's market investigation also revealed other causes for the decline, namely the perceived high price level for CDs, the general economic downturn, the record companies' failure to meet the consumers' tastes, the absence of quality content and of innovative artists, and the record companies' failure to adapt to the technological challenges of the Internet.

(59) Recently, there have been several indications, confirmed by the expectations of small and large record companies, that the decline trend is decelerating and that demand is likely to stabilise. According to the IFPI, the U.S. market for recorded music saw a recovery in the second half of 2003 which continued in the early months of 2004.[30] EMI announced that it expects total world-wide sales in 2004 to be between stable and minus 4%.[31] Sony expects the music market to decrease by [x%]* in 2004, by [y%; with y<x]* in 2005 and to be [...]* in 2006. BMG prepares forecasts for the different EEA countries. On average, BMG expects a decline of sales in the EEA by [0-5%]* in 2004, [...]* revenues in 2005 and [...]* growth in 2006. Also several responses to the Commission's market investigation expect a stabilisation of demand in the near future also in the EEA. The recovery of the industry is also confirmed by the growing profitability of the Parties' music businesses: Sony Music was profitable in the business year through 31 March 2004,[32] and Bertelsmann announced that the fourth

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26 F. Oberholzer, K. Strumpf: The Effect of File Sharing on Record Sales - An Empirical Analysis, Harvard, March 2004. The Commission acknowledges that there also other studies which consider illegal downloading as one of the reasons for the problems of the record industry.

27 See e.g. for Germany, "Wie teuer wird es denn nun?", http://www.spiegel.de/netzwelt/politik/0,1518,293096,00.html; 30 March 2004.

28 "Sharp Decline in Music File Swapping", Research Report from Pew Internet Project and comScore Media Metrix; Press Release 5.1.2004.

29 OJ L157, 30.4.2004, p.45. See also the amendments to the German Urhebergesetz (UrhG), in particular § 95a UrhG, which entered into force in September 2003. See also the UK Copyright and Related Rights Regulations 2003 of 3 October 2003, entered into force on 31 October 2003.

30 IFPI: World Sales 2003 – The Recording Industry, April 2004, p.1.

31 See Financial Times of 24 May 2004.

32 Parties' submission of 10.05.2004.

quarter 2003 and the first quarter 2004 have been BMG's most successful quarters ever.[33]

III. Possible Strengthening of a Collective Dominant Position in the Recorded Music Markets

1. Analysis of the United Kingdom, France, Germany, Italy and Spain

(60) In its analysis, the Commission in particular focussed on the big markets, namely the United Kingdom, France, Germany, Italy and Spain, where it analysed the price developments over the last years on the basis of data received from the 5 majors. The other national markets are dealt with below.

a. Market Structure in United Kingdom, France, Germany, Italy and Spain

(61) Prior to the analysis of the majors' price development, the market structure in the five largest Member States is discussed in the following recitals.

Table 5: United Kingdom

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Sony	[5-10%]*	[10-15%]*	[5-10%]*	[5-10%]*
Pro forma combined			[20-25%]*	[20-25%]*
Universal	[20-25%]*	[25-30%]*	[25-30%]*	[25-30%]*
EMI	[20-25%]*	[20-25%]*	[15-20%]*	[15-20%]*
Warner	[10-15%]*	[10-15%]*	[5-10%]*	[10-15%]*
Total independents	[20-25%]*	[15-20%]*	[20-25%*]	[15-20%]*
- Demon	[0-5%]*	[0-5%]*	[0-5%]*	n/a
- Ministry of Sound	[0-5%]*	[0-5%]*	[0-5%]*	n/a
- Sanctuary	[0-5%]*	[0-5%]*	[0-5%]*	n/a
- Telstar	n/a	n/a	[0-5%]*	n/a
- V2	n/a	n/a	[0-5%]*	n/a

Source: Notification and subsequent submissions by Parties

(62) In the United Kingdom, the smaller record companies account for approximately [20-25%]* of the market ([15-20%]* in 2003). Key independents are **Demon** and **Ministry of Sound** with [0-5%]* and [0-5%]* respectively in 2002. However, all important independents depend on distribution services by the majors. Demon, the largest independent, is distributed by [Major X]*. Ministry of Sound is mainly active in compilations and also has a distribution and sales arrangement with [Major X]*. **Sanctuary Records** ([0-5%]* in 2002) and **V2** ([0-5%]*) are distributed by Pinnacle, a Bertelsmann subsidiary, whereas **Telstar** ([0-5%]*) is distributed by BMG.

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[33] See "Musikgeschäft entzückt Bertelsmann", Financial Times Deutschland, 6.5.2004; and „Whitney Houstons Entdecker kehrt zurück"; http://www.spiegel.de/kultur/musik/0,1518,284767,00.html (03.02.2004).

Table 6: France

	2000	2001	2002	2003
BMG	[5-10%]*	[5-10%]*	[5-10%]*	[5-10%]*
Sony	[15-20%]*	[15-20%]*	[15-20%]*	[15-20%]*
Pro forma combined			**[20-25%]***	**[25-30%]***
Universal	[35-40%]*	[30-35%]*	[30-35%]*	[30-35%]*
EMI	[20-25%]*	[20-25%]*	[15-20%]*	[15-20%]*
Warner	[5-10%]*	[5-10%]*	[10-15%]*	[10-15%]*
Total independents	**[5-10%]***	**[10-15%]***	**[10-15%]***	**[10-15%]***
- Naïve	n/a	n/a	[0-5%]	n/a
- Wagram	n/a	n/a	[0-5%]	n/a
- V2	n/a	n/a	[0-5%]	n/a

Source: Notification and subsequent submissions by Parties

(63) In France, the independents represent an estimated [10-15%]* of the market ([10-15%]*in 2003). **Naïve** is the leading player with a share of [0-5%]*, among others due the success of Carla Bruni. Both Naïve and **Wagram** operate their own distribution systems in France, whereas V2's content is distributed by Sony.

Table 7: Germany

	2000	2001	2002	2003
BMG	[15-20%]*	[15-20%]*	[10-15%]*	[15-20%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Pro forma combined			**[25-30%]***	**[25-30%]***
Universal	[20-25%]*	[25-30%]*	[25-30%]*	[20-25%]*
EMI	[10-15%]*	[10-15%]*	[15-20%]*	[10-15%]*
Warner	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Total independents	**[20-25%]***	**[20-25%]***	**[15-20%]***	**[20-25%]***
- Edel	[5-10%]*	[0-5%]*	[0-5%]*	n/a
- Sanctuary	n/a	n/a	[0-5%]*	n/a
- ZYX	n/a	n/a	[0-5%]*	n/a
- SPV	n/a	n/a	[0-5%]*	n/a
- EFA	n/a	n/a	[0-5%]*	n/a

Source: Notification and subsequent submissions by Parties

(64) In Germany, independent labels accounted for some [15-20%]* of the market in 2002 ([20-25%]* in 2003). The leading independent is **Edel** with an estimated share of [0-5%]* in Germany and operational subsidiaries in a number of other Member States (United Kingdom, Austria, Denmark, Norway, Sweden, Finland, Italy and Portugal). It has its own distribution and sales force in some countries and also provides distribution services to third parties. **Sanctuary**, the second largest independent, is distributed by Bertelsmann's subsidiary Arvato. **ZYX** is a manufacturer of audiovisual carriers and also active in music publishing and music production. It distributes it owns products and has entered into licensing and distribution arrangements with other independent labels regarding Germany, Austria and Switzerland.

Table 8: Italy

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[15-20%]*
Sony	[15-20%]*	[10-15%]*	[10-15%]*	[15-20%]*
Pro forma combined			**[25-30%]***	**[30-35%]***
Universal	[25-30%]*	[25-30%]*	[25-30%]*	[20-25%]*
EMI	[20-25%]*	[15-20%]*	[15-20%]*	[15-20%]*
Warner	[15-20%]*	[15-20%]*	[15-20%]*	[15-20%]*
Total independents	**[0-5%]***	**[5-10%]***	**[10-15%]***	**[5-10%]***
- Universo	n/a	n/a	[0-5%]*	n/a
- Sugar	n/a	n/a	[0-5%]*	n/a

Source: Notification and subsequent submissions by Parties

(65) In Italy,[34] the combined market share of the independent record companies is approximately [10-15%]* in 2002 ([5-10%]* in 2003). The most significant independent label is **Universo** with a [0-5%]* market share; most of its revenue derives from compilations. **Sugar,** the second largest player, has a [0-5%]* market share and is distributed by [Major X]*. According to the notification, BMG enters into regular distribution deals with smaller record companies, including Universo.

Table 9: Spain

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Pro forma combined			**[20-25%]***	**[20-25%]***
Universal	[20-25%]*	[15-20%]*	[15-20%]*	[15-20%]*
EMI	[15-20%]*	[15-20%]*	[5-10%]*	[10-15%]*
Warner	[15-20%]*	[15-20%]*	[15-20%]*	[20-25%]*
Total independents	**[15-20%]***	**[25-30%]***	**[35-40%]***	**[25-30%]***
- Vale	n/a	n/a	[20-25%]*	n/a
- Divusca	n/a	n/a	[0-5%]*	n/a
- Gran Via Musical	n/a	n/a	[0-5%]*	n/a
- Subterfuge	n/a	n/a	[0-5%]*	n/a

Source: Notification and subsequent submissions by Parties

(66) In Spain, the smaller record companies collectively represented approximately [35-40%]* of the market in 2002 ([25-30%]* in 2003). In 2000, their combined market share had been between 12.5%, according to Music & Copyright,[35] and [15-20%]* according to the notification. Important independents are **Divusca** and **Gran Vía Musical** with market shares between [0-5%]* and [0-5%]*. The considerable increase of the independents' share in 2002 is primarily due to **Vale**

[34] In Italy, the Autorità Garante della Concorrenza e del Mercato (AGCM) found, in 1997, that the Federazione dell' Industria Musicale Italiana (FIMI) had participated in concerted practices of the five majors which aimed at fixing uniform wholesale prices: Decision of the AGCM of 10 October 1997, Associazione Vendomusica / Case Discografiche Multinazionali – FIMI. The *Autorità* found a high degree of uniformity regarding the wholesale price level, in particular for "hits", and the supply conditions applied to wholesalers and retailers (discounts, payment conditions and returns). Given that the Autorità's decision dates from 1997, it is only of limited relevance for the current investigation.

[35] Music & Copyright, number 198, p.8.

Music's success in marketing the recordings associated with the Pop Idol-style TV talent show *Operción Triunfo (OT)*. Vale had a market share of [20-25%]* in 2002 and has its own distribution facilities and acts as distributor to non-affiliated labels. However, according to a recent article in the specialised music periodical "Music & Copyright", the viewing figures of OT and the related sound carrier sales fell steeply for the third series (running from autumn 2003 to early 2004).[36] Music & Copyright estimates that some 65% of Vale's 2002 revenues were derived from OT. These tendencies were largely confirmed in the Commission's market investigation. According to the Parties' submission of 29 June 2004, Vale's market share fell to [10-15%]* in 2003. Therefore, the Commission considers Vale Music as an important independent label which is, however, not in a position to exert competitive constraints on the majors' behaviour. In addition, Vale Music depends on the services of [Major X]* for distribution in Latin America and the U.S. Latin market.

b. Assessment of possible strengthening of collective dominance in the United Kingdom, France, Germany, Italy and Spain

(67) According to the case law of the Court of Justice and the Court of First Instance of the European Communities a collective dominant position significantly impeding effective competition in the common market or a substantial part of it may arise as the result of a concentration where, in view of the actual characteristics of the relevant market and of the alteration in its structure that the transaction would entail, the latter would make each member of the dominant oligopoly, as it becomes aware of its interests, consider it possible, economically rational and hence preferable, to adopt on a lasting basis a common policy on the market with the aim of selling at above competitive prices.[37]

(68) The Court of First Instance ruled in the Airtours judgment[38] that a collective dominant position requires that the companies reach a common understanding about the terms of coordination and that the following three conditions are met as necessary for co-ordination to be sustainable. First, the coordinating firms must be able to monitor whether the terms of coordination are adhered to. Second, discipline requires that there is some form of deterrent mechanism in case of deviations. Third, the reaction of outsiders, such a current and future competitors not participating in the coordination, as well as customers, should not be able to jeopardise the results expected from the coordination. According to the Court of Justice[39] and the Court of First Instance[40] the assessment of the existence of these

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36 Music&Copyright, 18.02.2004, p. 12.

37 Court of First Instance, Case T-102/96, Gencor v. Commission, ECR 1999, II-753, paragraphs 276, 277; Case T-342/99, Airtours v. Commission, ECR 2002, II-2585, paragraph 61.

38 Airtours v. Commission, paragraph 59.

39 Joined Cases C-68/94 and C-30/95 "Kali &Salz", ECR 1998, I-1375, paragraph 228.

40 Airtours v. Commission, paragraph 63.

elements shall be supported by a sufficiently cogent and consistent body of evidence.

aa. Common understanding of the five majors on prices

(69) In assessing whether there is an existing collective dominant position in the markets for recorded music, the Commission analysed whether in the last three to four years a coordinated price policy of the majors in the United Kingdom, France, Germany, Italy and Spain could be identified.

(70) In order to assess whether the majors' wholesale prices have been coordinated, the Commission has first analysed the development of average net prices on a quarterly basis for the top 100 single albums of each major in the five largest Member States. In the Commission's view average prices are an appropriate means to assess parallelism in the pricing behaviour of the majors. The Parties submitted that average prices may be influenced by changes in the product mix, for example different mix of budget, mid-price and full price albums, by pricing dispersions at the level of the individual releases and over the lifetime of an album. The Commission considers, nevertheless, that in this case the average prices – in connection with further elements, as listed in recital (73) below - give a representative picture of the developments of the majors' prices in the market and provide an appropriate basis for the assessment as to whether there has been parallelism in the pricing behaviour of the majors.

(71) For the purpose of assessing parallelism in pricing behaviour, the Commission analysed transaction data in real (inflation-corrected) prices, provided by the Parties and the three other majors.[41] The album level data provided by the majors only included the annual 100 best-selling titles of each major, thereby limiting the sample on which a detailed analysis was carried out. Still, the Commission deems the average prices of the top 100 album titles representative of the majors' average CD prices since top 100 album sales cover at least 70 to 80 percent of their total music sales. In order to ensure comparability, the Commission relied on price data for a consistent product, namely single pocket album CDs, thereby excluding singles, maxi-singles, double albums, boxes, and enhanced albums.

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[41] The data consisted of monthly data regarding PPD, net sales, gross units, returns units and return value for each of the top 100 albums sold to the top 20 customers (including independent retailers) per country.

(72) The Commission analysed the development of
(a) average net prices,[42]
(b) Published Prices to Dealers ("PPDs")
(c) gross and net price ratios,
(d) invoice discounts and retrospective discounts[43].

(73) The Commission therefore first analysed the majors' pricing behaviour on the basis of their average wholesale net prices. In a second step the Commission examined whether any price coordination, on the basis of a parallelism in average prices, could have been reached in using list prices (PPDs) as focal points. In a third step, the Commission analysed whether the different majors' discounts were aligned and sufficiently transparent in order to allow efficient monitoring of any price coordination also on the level of net prices. According to the Parties, different kinds of discounts are granted to customers: file and campaign discounts on the invoice level, retrospective discounts on a volume basis and co-op spending. The Commission's investigation showed, first, that co-op spending is rather a kind of marketing payment than a proper discount and, second, that the use and importance of the different discounts varies from country to country.

United Kingdom

(74) In the United Kingdom the Commission has observed a [...]* decrease of less than [0-100]* pence in real terms or [5-10%]* of the majors' net average real prices between 2000 and 2003. The net average real prices of all majors moved within a range of approximately GBP 0.50 – GBP 0.70 during most of that time. They moved to some extent in parallel but also showed some divergences. The average difference between the bottom and the top of the range was GBP 0.67 and the maximum difference was – in one single trimester - GBP 1.12. It appears that, at the end of 1999 and in 2000 one major moved from the upper to the lower end of the range, still remaining close to the other majors.[44] Since mid-2002, and even more since the beginning of 2003, the same major appears to have moved back towards the centre of the bundle of the majors' net average real prices.

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42 Average net prices were calculated at a quarterly level by dividing the total net value sales of the album by the total gross units sold of the album for a particular quarter. Average gross prices were calculated by dividing the album's total gross value sales in the quarter by the total gross units sold. Net value sales were defined by the majors as the gross value sales less the invoice discounts. Only BMG and Sony provided data on gross sales by title. There are no retrospective discounts at the title level and those discounts are not included in the time series of average prices.

43 Aggregate data on invoice discount, retrospective discounts and coop payments at the customer level were obtained from the Parties. This data provided yearly gross sales data, yearly amounts of invoice discounts, yearly amounts of retrospective discounts and yearly amounts of returns for each of the top 20 customers and for the years 2000-2003.

44 The average net prices of that major were lower than those of the other majors for not more than four subsequent quarters in 2000/2001.

(75) On the basis of net average real prices, the Commission thus found some parallelism and a relatively similar price development of the majors. However, these observations were as such not conclusive enough to constitute sufficient evidence for coordinated pricing behaviour in the past. Therefore, the Commission further investigated whether additional elements, namely list prices and discounts were aligned and sufficiently transparent to provide sufficient evidence for coordination.

(76) The Commission found some indications that PPDs could have been used as focal points for an alignment of the majors' prices in the United Kingdom. Although the Parties put forward that they use more than 100 PPDs, the top 5 PPDs of both Parties accounted for more than 85% of their total sales in 2002. Similarly, each major generated with its three most important PPDs more than 80% of its total top 100 single album CD net sales in 2003. Moreover, one or two PPDs within a range of 17 pence (between GBP 8.98 and GBP 9.15) accounted for more than 47% of each major's top 100 single album CD net sales in 2003. In the light of these observations, list prices of the best selling albums appear thus to be rather aligned. The Commission further found that the PPDs are rather transparent as they are available in the majors' catalogues. Monitoring of other majors' list pricing appears therefore to be possible.

(77) The Commission's analysis showed that transaction net prices are closely linked to gross prices (PPDs) as, for both Sony and BMG, their average gross real prices and average net real prices have moved closely in parallel over the last six years as also reflected by very stable net to gross price ratios across albums and time. If a significant deviation from pricing policies was being implemented by the majors through the grant of discounts, this deviation would have been reflected in their average net prices even if those higher discounts were granted only in respect of the best selling albums.

(78) However, the Commission found that the level of the different majors' discounts varied to some extent. In the United Kingdom in 2003, Sony's and BMG's invoice (file and campaign) discounts made up [15-20%]* to [20-25%]* of their respective aggregate gross sales to their top 20 customers whereas co-op payments accounted only for [0-5%]* of both Parties' gross sales and retrospective discounts were not granted at all. Therefore, invoice discounts are by far the most important discounts in the United Kingdom.

(79) On a customer-by-customer basis, however, the Commission found a certain degree of fluctuation and also differences of 2-5 percent points between Sony's and BMG's invoice discounts for most of their top 10 customers, and of more than 5 percent points for some customers in some years. In addition, the Parties submitted data according to which invoice discounts for a given customer varied over time and from album to album, and discounts for a given album varied from customer to customer. The market investigation indicated that these fluctuations are mainly the result of campaign discounts which are more flexibly used than file discounts that are regularly fixed on an annual basis. On the basis of these observations, it cannot be established that invoice discounts are sufficiently aligned between the Parties.

(80) As regards transparency of discounts, a majority of the UK customers' responses to the Commission's market investigation indicated that the major record

companies have some knowledge of their competitors' file discounts due to their permanent interaction with the same customer base.[45] However, it appears that campaign discounts are less transparent than file discounts and that their monitoring requires also a careful observation of promotional developments on the retail market. Although the Commission found that both Sony and BMG have set up a system of weekly reports by their sales forces, it could not be established that these reports ensure a sufficient degree of transparency of competitors' campaign discounts.

France

(81) In France the Commission has observed a [...]* decrease of less than [0.00-1.00]*Euro in real terms or [0-5%]* of the majors' net average real prices between 2000 and 2003. The different majors' net average real prices developed within a range of EUR 1.00 to EUR 1.30 during most of the period. The average difference between the bottom and the top of the range was EUR 1.25 and– in two trimesters in 2000 - the difference exceeded EUR 2.00. However, during the last two years, the net average real prices of the majors have been rather converging at a stable real price level, thereby narrowing down the range between the major with the highest and the one with the lowest net average real prices to less than EUR 1.00 in several trimesters. Regarding price parallelism, it can thus be observed that the different majors' net average real prices moved in a roughly parallel pattern but also showed some diverging movements.

(82) On the basis of net average real prices, the Commission thus found some parallelism and a relatively similar price development of the majors. However, these observations were, as such, not conclusive enough to constitute sufficient evidence of coordinated pricing behaviour in the past. Therefore, the Commission further investigated whether additional elements, namely list prices and discounts, were aligned and sufficiently transparent to provide sufficient evidence for coordination.

(83) The Commission found some indications that PPDs could have been used as focal points for an alignment of the majors' prices in France. Although the Parties submitted that they use more than [>50]* PPDs, the top 5 PPDs of both Parties accounted for more than 60% of their total sales in 2002. Similarly, each major generated with its three most important PPDs more than 60% of its total top 100 single album CD net sales in 2003. Moreover, one to three PPDs within a range of EUR 0.91 (between EUR 13.57 and EUR 14.48) accounted for more than 48% of each major's top 100 single album CD net sales in 2003. In the light of these observations, list prices of the best selling albums appear thus to be rather aligned. The Commission further found that the PPDs are rather transparent as they are available in the majors' catalogues. Monitoring of other majors' list pricing appears therefore to be possible.

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[45] Four out of five of the UK-retailers which replied to the question said that majors are aware of each other's PPDs and discounts; one respondent answered in the negative.

(84) The Commission's analysis showed that transaction net prices are closely linked to gross prices (PPDs) as, for both Sony and BMG, their average gross real prices and average net real prices have moved closely in parallel over the last six years as also reflected by very stable net to gross price ratios across albums and time.

(85) However, the Commission found that the level of the different majors' various discounts varied to some extent. In France in 2003, Sony's and BMG's invoice (file and campaign) discounts made up [0-5%]* (BMG) to [10-15%]*(Sony) of their respective aggregate gross sales to their top 20 customers whereas co-op payments accounted only for less than [0-5%]* of their gross sales.[46] Retrospective discounts accounted for [0-5%]* of Sony's gross sales and [10-15%]* of BMG's gross sales. In their response to the SO the Parties submitted that BMG's retrospective discounts were more than double the size of its invoice discounts.[47] However, it appears that this somewhat exceptional ratio is a consequence of BMG considering so-called "contract discounts", accounting for approximately [5-10%]* of its gross sales, as retrospective discounts.[48] The Commission had some doubts as to whether this classification by BMG reflected business reality. However, in response to the Commission's question in the oral hearing whether there was any mistaken calculation or classification of discounts, the Parties explicitly confirmed that all calculations and classifications were correct. On the basis of the information available, therefore, invoice discounts are Sony's most important discounts in France whereas for BMG retrospective discounts are by far the most important discounts in France.

(86) On a customer-by-customer basis the Commission found, for the reasons described in the recital above, important differences of up to 10 percent points between Sony's and BMG's invoice discounts for their common top 15 customers. Also on the level of total discounts (invoice, retrospective and "contract discounts" combined) to their common customers, differences of up to 3 percent points between Sony and BMG could be observed in 2003; these differences even amounted to approximately 5% for 3 of their 15 common top customers analysed. The market investigation indicated that these fluctuations are mainly the result of campaign discounts which are more flexibly used than other (file, contract or retrospective) discounts that are regularly fixed on an annual basis. In addition, the Parties submitted data according to which discounts for a given customer varied over time and from album to album, and discounts for a given album varied from customer to customer. On the basis of these observations, it cannot be established that discounts are sufficiently aligned between the Parties.

(87) As regards transparency of discounts, a majority of the French customers' responses to the Commission's investigation indicated that the major record companies have some knowledge of their competitors' file discounts due to their

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[46] BMG also granted "wholesale discounts" of approximately [5-10%]* to five wholesalers.

[47] Page 37 of "Rebuttal paper".

[48] Cf. Table A.3 of Volume III to the Parties' response to the Statement of Objections.

permanent interaction with the same customer base.[49] However, it appears that campaign discounts are less transparent than file discounts and that their monitoring also requires a careful observation of promotional developments on the retail market. Although the Commission found that both Sony and BMG have set up a system of weekly reports by their sales forces, it could not be established that these reports ensure a sufficient degree of transparency of competitors' campaign discounts.

Germany

(88) In Germany, the Commission has observed a [...]* decrease of [0.00-1.00]* Euro in real terms or [0-5%]* of the majors' net average real prices between 2000 and 2003. The different majors' net average real prices developed within a range of approximately EUR 1.50 to EUR 2.00 which is somewhat wider than in other countries. The average difference between the bottom and the top of the range was EUR 1.81, and the maximum difference was more than EUR 3.00, in two trimesters.[50] Although the different majors' net average real prices show a similar slight downward trend, their development has been less parallel than in other countries; in particular the breadth of the range has widened and one major has moved from the upper end of the range to the lower end of the range over the last four years.

(89) On the basis of net average real prices, the Commission thus found some parallelism and a relatively similar price development of the majors although less similar than in other countries. However, these observations were as such not conclusive enough to constitute sufficient evidence for coordinated pricing behaviour in the past. Therefore, the Commission further investigated whether additional elements, namely list prices and discounts, were aligned and sufficiently transparent to provide evidence of coordination.

(90) The Commission found some indications that PPDs could have been used as focal points for an alignment of the majors' prices in Germany. Although BMG put forward that it uses more than [>100]* PPDs,[51] the top 5 PPDs of both Parties accounted for more than 55% of their total sales in 2002. Similarly, each major generated with its three most important PPDs more than 55% of its total top 100 single album CD net sales in 2003. Moreover, one to three PPDs within a range of EUR 1.41 (between EUR 12.37 and EUR 13.78) accounted for more than 57% of each major's top 100 single album CD net sales in 2003. In the light of these

49 Three out of four of the French retailers which replied to the question said that majors are aware of each other's PPDs and discounts; one respondent answered that it did not know whether majors are aware of each other's discounts.

50 However, these exceptionally high divergences were both times due to a large amount of sales by one major of albums at a PPD of less than EUR 5.00, whereby this major's average price was temporarily considerably lowered (as also its immediate and strong increase in the respective following trimester indicates). The two divergences of more than EUR 3.00 are therefore to be considered as statistical outliers.

51 Sony did not provide data concerning its total number of PPDs used in Germany.

observations, list prices of the best selling albums thus appear to be to some extent aligned. The Commission further found that the PPDs are rather transparent as they are available in the majors' catalogues. Monitoring of other majors' list pricing appears therefore to be possible.

(91) The Commission's analysis showed that transaction net prices are closely linked to gross prices (PPDs) as, for both Sony and BMG, their average gross real prices and average net real prices have moved closely in parallel over the last six years as also reflected by very stable net to gross price ratios across albums and time.

(92) However, the Commission found that the level of the different majors' various discounts varied to some extent. In Germany in 2003, Sony's and BMG's invoice (file and campaign) discounts made up [10-15%]* to [15-20%]* of their respective aggregate gross sales to their top 20 customers whereas retrospective discounts accounted for [0-5%]* and co-op payments for less than [0-5%]* of both Parties' gross sales. Therefore, invoice discounts are by far the most important discounts in Germany.

(93) On a customer-by-customer basis, however, the Commission found a certain degree of fluctuation and differences of 2-5 percent points between Sony's and BMG's invoice discounts for most of their common top 10 customers, and of more than 5 percent points for some customers in several years. In addition, the Parties submitted data according to which invoice discounts for a given customer varied over time and from album to album, and discounts for a given album varied from customer to customer. The market investigation indicated that these fluctuations are mainly the result of campaign discounts which are more flexibly used than file discounts that are regularly fixed on an annual basis. On the basis of these observations, it cannot be established that invoice discounts are sufficiently aligned between the Parties.

(94) As regards transparency of discounts, a majority of the German customers' responses to the Commission's investigation indicated that the major record companies have some knowledge of their competitors' file discounts due to their permanent interaction with the same customer base.[52] However, it appears that campaign discounts are less transparent than file discounts and that their monitoring also requires a careful observation of promotional developments on the retail market. Although the Commission found that both Sony and BMG have set up a system of weekly reports by their sales forces, it could not be established that these reports ensure a sufficient degree of transparency of competitors' campaign discounts.

Italy

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[52] Five out of eight of the German retailers which replied to the question said that majors are aware of each others PPDs and discounts; one respondent said that they are partly aware of each other's PPDs and discounts; two respondents answered that they did not know whether majors are aware of each other's discounts.

(95) In Italy, the Commission has observed a [...]* decrease of less than [0.00-1.00]*Euro in real terms or [0-5%]* of the majors' net average real prices between 2000 and 2003. The different majors' net average real prices developed for most of the period in a rather parallel pattern and within a range of EUR 1.00 to EUR 1.60. The average difference between the bottom and the top of the range was EUR 1.53, and the maximum difference exceeded – in two trimesters – EUR 3.00, with an absolute maximum of EUR 3.19.[53] In 2003, the breadth of the range narrowed down to approximately EUR 0.50-0.70, while real average net prices were increasing for all majors.

(96) On the basis of net average real prices, the Commission thus found some parallelism and a relatively similar price development of the majors. However, these observations were as such not conclusive enough to constitute sufficient evidence for coordinated pricing behaviour in the past. Therefore, the Commission further investigated whether additional elements, namely list prices and discounts were aligned and sufficiently transparent to provide sufficient evidence for coordination.

(97) The Commission found some indications that PPDs could have been used as focal points for an alignment of the majors' prices in Italy. Although the Parties submitted that they use more than 100 PPDs, the top 5 PPDs of both Parties accounted for more than 74% of their total sales in 2002. Similarly, each major generated with its three most important PPDs more than 64% of its total top 100 single album CD net sales in 2003.[54] Moreover, one or two PPDs within a range of EUR 0.36 (between EUR 12.55 and EUR 12.91) accounted for more than 60% of each of three major's top 100 single album CD net sales in 2003. In the light of these observations, list prices of the best selling albums thus appear to be rather aligned. The Commission further found that the PPDs are rather transparent as they are available in the majors' catalogues. Monitoring of other majors' list pricing therefore appears to be possible.

(98) The Commission's analysis showed that transaction net prices are closely linked to gross prices (PPDs) as, for both Sony and BMG, their average gross real prices and average net real prices have moved closely in parallel over the last six years as also reflected by very stable net to gross price ratios across albums and time.

(99) However, the Commission found that the level of the different majors' various discounts varied to some extent. In Italy in 2003, Sony's and BMG's invoice (file and campaign) discounts made up [10-15%]* to [10-15%]* of their respective aggregate gross sales to their top 20 customers whereas retrospective discounts accounted only for [0-5%]* of their gross sales and co-op payments were not granted at all. Therefore, invoice discounts are by far the most important discounts in Italy.

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53 However, these exceptionally high divergences were both times due to the large amount of sales by a major of albums at a PPD of less than EUR 5.00, whereby this major's average price was temporarily considerably lowered (as also its strong increase in the respective following trimester indicates). The two divergences of more than EUR 3.00 therefore are to be considered as statistical outliers.

54 Only four majors were taken into account in this respect regarding Italy as one major had not provided the relevant data.

(100) On a customer-by-customer basis, however, the Commission found a certain degree of fluctuation and also differences of 1-3 percent points between Sony's and BMG's invoice discounts for most of their top 10 customers. In addition, the Parties submitted data according to which invoice discounts for a given customer varied over time and from album to album, and discounts for a given album varied from customer to customer. The market investigation indicated that these fluctuations are mainly the result of campaign discounts which are more flexibly used than file discounts that are regularly fixed on an annual basis. On the basis of these observations, it cannot be established that invoice discounts are sufficiently aligned between the Parties.

(101) As regards transparency of discounts, a majority of the Italian customers' responses to the Commission's investigation indicated that the major record companies have some knowledge of their competitors' file discounts due to their permanent interaction with the same customer base.[55] However, it appears that campaign discounts are less transparent and that their monitoring requires also careful monitoring of promotional developments on the retail market. Although the Commission found that both Sony and BMG have set up a system of weekly reports by their sales forces, it could not be established that these reports ensure a sufficient degree of transparency of competitors' campaign discounts.

Spain

(102) In Spain the Commission has observed a [...]* decrease of less than [0.00-1.00]* Euro in real terms or [0-5%]* of the majors' net average real prices between 2000 and 2003. The different majors' net average real prices developed within a range of EUR 1.00 to EUR 1.50 during most of the time. The average difference between the bottom and the top of the range was EUR 1.42, and the maximum difference was – in one single trimester - EUR 2.19. The different majors' net average real prices moved to some extent in parallel but also showed some minor diverging movements. However, the Commission has observed that the majors' net average real prices showed a slight upward trend in 2003 and that the breadth of the range was narrowing to approximately EUR 1.00 at that time.

(103) On the basis of net average real prices, the Commission thus found some parallelism and a relatively similar price development of the majors. However, these observations were as such not conclusive enough to constitute sufficient evidence for coordinated pricing behaviour in the past. Therefore, the Commission further investigated whether additional elements, namely list prices and discounts were aligned and sufficiently transparent to provide sufficient evidence for coordination.

(104) The Commission found some indications that PPDs could have been used as focal points for an alignment of the majors' prices in Spain. Although the Parties submitted that they use more than [20-50]* PPDs, the top 5 PPDs of both Parties accounted for more than 78% of their total sales in 2002. Similarly, each major

[55] Five out of five of the Italian retailers which replied to the question said that majors are aware of each other's PPDs and discounts.

generated with its three most important PPDs more than 57% of its total top 100 single album CD net sales in 2003.[56] Moreover, one or two PPDs within a range of EUR 0.98 (between EUR 12.02 and EUR 13.00) accounted for more than 25% of each major's top 100 single album CD net sales in 2003. In the light of these observations, list prices of the best selling albums appear thus to be to some extent aligned, although less similar than in other countries. The Commission further found that the "Published Prices to Dealers" are rather transparent as they are available in the majors' catalogues. Monitoring of other majors' list pricing appears therefore to be possible.

(105) The Commission's analysis showed that transaction net prices are closely linked to gross prices (PPDs) as, for both Sony and BMG, their average gross real prices and average net real prices have moved closely in parallel over the last six years as also reflected by very stable net to gross price ratios across albums and time.

(106) However, the Commission found that the level of the different majors' various discounts varied to some extent. In Spain in 2003, Sony's and BMG's invoice (file and campaign) discounts made up [15-20%]* to [15-20%]* of their respective aggregate gross sales to their top 20 customers whereas retrospective discounts accounted only for less than [0-5%]* of both Parties' gross sales and co-op payments were of minor importance (less than [0-5%]* of both Parties gross sales). Therefore, invoice discounts are by far the most important discounts in Spain.

(107) On a customer-by-customer basis, however, the Commission found a certain degree of fluctuation and differences of 2-5 percent points between Sony's and BMG's invoice discounts for most of their top 10 customers, and of more than 5 percent points for some customers in single years. In addition, the Parties submitted data according to which invoice discounts for a given customer varied over time and from album to album, and discounts for a given album varied from customer to customer. The market investigation indicated that these fluctuations are mainly the result of campaign discounts which are more flexibly used than file discounts which are regularly fixed on an annual basis. On the basis of these observations, it cannot be established that invoice discounts are sufficiently aligned between the Parties.

(108) As regards to transparency of discounts, several Spanish customers' responses to the Commission's investigation indicated that the major record companies have some knowledge of their competitors' file discounts due to their permanent interaction with the same customer base.[57] However, it appears that campaign discounts are less transparent than file discounts and that their monitoring also requires a careful observation of promotional developments on the retail market. Although the Commission found that both Sony and BMG have set up a system of weekly reports by their sales forces, it could not be established that these

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[56] Only four majors were taken into account in this respect regarding Spain as one major had not provided the relevant data.

[57] Two out of four of the Spanish retailers which replied to the question (excluding subsidiaries of the Parties) said that majors are aware of each other's PPDs and discounts; two respondents answered that they did not know whether majors are aware of each other's discounts.

reports ensure a sufficient degree of transparency of competitors' campaign discounts.

bb. Elements of collective dominance

(109) As the results of the Commission's detailed analysis of the majors' price development in the five largest Member States showed some indications of coordinated behaviour which were as such, however, not sufficient to establish existing collective dominance, the Commission further analysed whether the markets for recorded music were characterised by features facilitating collective dominance.

Product homogeneity

(110) In the notification, the Parties submit that recorded music is a heterogeneous product as each release is unique. However, they recognise that most consumers purchase recorded music from multiple artists and genres, and that the combination of individual tastes affecting the selection and purchase of musical recordings ultimately results in a continuum of substitutability. It has to be emphasised that the format of recorded music is homogenous as CD albums are the predominant format which accounts for more than 80% of the Parties' music sales in the EEA. Regarding the content, all majors own large back catalogues and cover all kinds of genres, but the content of individual albums is quite heterogeneous. Despite the heterogeneity of the content, the way in which albums are priced and marketed on the wholesale level appears to be quite standardized. With respect to discounts and agreed return rates (for unsold records), the majors do usually not distinguish between genres or types of albums in their agreements with retailers and wholesalers. If any differentiation is made at all, it distinguishes only between "pop", "classical" and, more rarely, "TV-advertised" albums. However, the pricing, naturally, also depends on the success of the album. A further differentiation on individual album level is made as regards campaign discounts. The heterogeneity in the content, with these implications for pricing, reduces transparency in the market and makes tacit collusion more difficult since it requires some monitoring on the level of individual albums.

Transparency

(111) Despite the fact that sales of albums take place in few price points, the variety of albums priced at different list prices could complicate the monitoring of a tacit agreement. However, majors only need to monitor the pricing points of a limited number of best selling albums to account for most of the sales. Data provided by the Parties show that the top 20 titles each year account for at least half the yearly sales for BMG in all countries except Germany where they account for a third of the yearly sales. In the case of Sony the top 20 titles each year accounted for between 30 and 60% of total sales in any one country, and of more than half the yearly sales in a number of countries, for example the United Kingdom, Italy, Spain and the Scandinavian countries. Nevertheless, as set out for the five large Member States, further monitoring on album level is needed in particular in

relation to campaign discounts. The market investigation shows that this could reduce transparency in the market and may make tacit collusion more difficult. The Commission has not found sufficient evidence to conclude that these difficulties have been overcome in the past.

(112) There are further devices in the market which increase transparency and could facilitate the monitoring of an agreement. The publication of weekly hit charts with information on sales at title level makes it very easy to identify instantly what titles become hits and generate the bulk of sales. Such availability of weekly public information on sales at the title level greatly facilitates monitoring on the part of the majors. Further, there is certain stability in the customer base of the majors. The nature of the market for recorded music is such that retailers view the majors as providing complementary products for their establishments. In order for a music retailer to be successful, it needs to carry products from all majors. As a consequence, the industry is characterized by long term stable relationships between retailers and all majors. Moreover, a large part of the majors' sales of recorded music is channelled to a limited number of customers. This situation of a limited number of players in the market is conducive to the adoption of cooperative strategies on behalf of the majors and also facilitates the monitoring and information flow.

(113) A further source of transparency is the monitoring of the retail market. The market investigation revealed that Sony and BMG have set up a system of weekly (with differences between the Member States) reports, which include information on competitors. The market investigation also confirmed that the major record companies' sales forces are in regular and permanent contact with retailers and wholesalers as negotiations of promotional support and of campaign discounts often take place on a weekly basis. However, the Commission has not found sufficient evidence that, by monitoring retail prices or by contacts with retailers, the majors have overcome in the past the deficits as regards the transparency of discounts, in particular campaign discounts as described for the five large Member States.

Retaliation

(114) The Commission further explored whether indications could be found that majors have retaliated against any "cheating" major in the past concerning the markets for recorded music. Indications for retaliatory action in the past could be seen as pointing to the existence of a collective dominant position in the markets for recorded music. The Commission therefore investigated whether majors have retaliated by (i) a (temporary) return to competitive behaviour, or by the (ii) exclusion of the deviator from compilation joint ventures and agreements. In addition, due to the multi-market contacts between the majors, retaliation could also have happened with respect to online music markets and music publishing markets.

(115) The other majors could exclude the "cheater" from their compilation joint ventures or refuse to license tracks for compilation albums released by the deviating major. Multi-artist compilations such as "Hits 2003", "Bravo Hits" or "Knuffelrock" require the approval of the record labels of all artists involved. It appears from the market investigation that the combination of artists from different labels makes it possible to cover a broader range of the charts, or of the genre to which the compilation refers. Therefore, the appearance of artists from more than one record company appears to be a key factor for the success of a compilation. Every year, there are several hundreds of compilations released by the majors, and an important proportion of them reach very high sales figures. Altogether, these multi-artist/labels compilations account for approximately 15-20% of the overall market for recorded music according to the notification.[58]

(116) In 2003, Sony had joint venture agreements with at least one other major in all EEA countries, except Ireland (covered by United Kingdom compilation joint venture agreements), Luxembourg, Liechtenstein and Iceland. In 10 of these countries (except Belgium, Norway and Sweden), Sony participated in several joint ventures with different partners. In 2002[59] BMG had joint venture agreements with at least one other major in 11 Member States, except Greece (where BMG's catalogue is licensed to EMI), Ireland (covered by United Kingdom compilation joint venture agreements), Portugal and Luxembourg. In France, Germany, Italy and Spain, BMG was party to several joint venture agreements with different partners. For both Parties, some of their joint ventures included three or four majors in several countries. The responses from the other majors show a similar picture, with compilation joint ventures with one or more partners in most EEA Member States. It appears that joint venture compilations involving in total two or three majors constitute by far the most successful and important compilations both in terms of (compilation album) releases and sales (revenues).[60] These agreements can usually be terminated annually with two months notice. According to information provided by the Parties, compilation joint ventures also cooperate on an ad-hoc basis with each other or other majors in order to license tracks or to jointly obtain rights to a compilation brand name. In addition to their links via joint ventures, the major record companies also license, to a considerable extent, single tracks for exploitation by another major (or joint venture) in the release of a compilation album.

(117) In case of a persistent deviation by one major, the other majors could therefore exclude the deviator from the conclusion of new joint ventures, or they could refuse to license their songs for the deviator's compilations, or they could even terminate some of the existing joint ventures.

(118) However, in this case the Commission has found no indications that, in response to a major's deviation from a common policy, other majors have been excluded

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58 In their response to the Statement of Objections the Parties stated that multi artist/label compilations accounted for only 3-4% of total record releases. However, the reference to releases largely underestimates the importance of compilations in terms of sales value.

59 The 2002 figures were confirmed by BMG's 2003 figures, to the extent 2003 data was provided by BMG.

60 On the basis of figures provided by the Parties; BMG data not available for all years and/or countries.

from compilations joint ventures, or that there has been a (temporary) return to competitive behaviour as a retaliatory measure, or that retaliation has occurred in the online music market or music publishing markets or that threats of such retaliatory measures have been made, although these measures could in general represent credible possibilities for retaliation by the majors in the markets for recorded music. The Commission in this case has therefore found no evidence that these means have been used or threatened in the past as element for the proof of an existing collective dominant position.

2. Smaller Countries

a. Market structure

(119) In this section, the smaller national markets in the Netherlands, Sweden, Ireland, Austria, Belgium, Denmark, Finland, Norway, Portugal and Greece are analysed.[61] The Commission analysed the situation in the smaller territories on the basis of the data received from the Parties.

Table 10: The Netherlands

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Sony	[15-20%]*	[15-20%]*	[15-20%]*	[10-15%]*
Pro forma combined			**[25-30%]***	**[25-30%]***
Universal	[25-30%]*	[25-30%]*	[20-25%]*	[20-25%]*
EMI	[15-20%]*	[15-20%]*	[10-15%]*	[15-20%]*
Warner	[10-15%]*	[10-15%]*	[5-10%]*	[5-10%]*
Total independents	**[15-20%]***	**[15-20%]***	**[20-25%]***	**[25-30%]***
- Disky	n/a	n/a	[5-10%]*	n/a
- Roadrunner	n/a	n/a	[0-5%]*	n/a
- Suburban	n/a	n/a	[0-5%]*	n/a
- Black Hole	n/a	n/a	[0-5%]*	n/a
- Digidance	n/a	n/a	[0-5%]*	n/a
- PIAS	n/a	n/a	[0-5%]*	n/a

Source: Notification / Submission from the Parties

(120) In the Netherlands the independents sector accounts for a total market share of approximately [20-25%]*. Key independent is **Disky** ([5-10%)*, mainly active in the budget price segment. The second largest independent record company is **Roadrunner** with a market share of [0-5%]*. Other independents include **Suburban** and Belgium-based **PIAS**, having market shares of [0-5%]* and [0-

61 For a number of EEA countries (Ireland, Austria, Belgium, Denmark, Finland, Norway, Portugal and Greece), the Parties only provided the aggregate share of the independents for 2002. Where possible the Commission has added information based on the outcome of the market investigation, however, where only the total market share of the independents has been provided, no further details on individual market shares were available. Furthermore, for the markets of Lichtenstein, Luxembourg and Iceland no separate analysis could be carried out since separate figures are not available. The parties supply customers in Lichtenstein from their operations in Switzerland or Austria, customers in Luxembourg are supplied by their Belgian operations and customers in Iceland are supplied by a distributor or a licensee.

5%]* respectively in 2002. According to the notification, the independents play a significant role in the dance scene; labels include **Black Hole** (DJ Tiësto) and **Digidance**, having a market share of around [0-5%]* in 2002. Disky, Roadrunner, Digidance and PIAS have their own distribution networks in the Netherlands whereas Black Hole is distributed by Arvato (Bertelsmann).

(121) For the smaller countries, the Commission carried out an analysis of the PPDs on the basis of the information received from the Parties. In the Netherlands, Sony's top 5 PPDs accounted for [60-70%]* and BMG's top 5 PPDs for [50-60%]* of their respective total sales in 2002. The top 2 PPDs, accounting for [30-40%]* of Sony's total sales and for [40-50%]* of BMG's total sales, are exactly the same for both Sony and BMG and are in a range of 50 cents (EUR [...]* and EUR [...]*). It has to be noted that the percentages for which the two PPDs account would be even higher with respect to the Top 100 albums, which were also taken into account for the five large countries.

(122) In the Netherlands, invoice discounts are the most important type of discounts. According to the notification, for the year 2002 average invoice discounts ranged from [10-15%]* to [20-25%]* for BMG's top 10 customers and from [10-15%]* to [20-25%]* for Sony's Top 10 customers [The difference between BMG's and Sony's respective minimum average invoice discounts was 1.4 percent points and 3.4 percent points for their maximum average invoice discounts]*. Co-op payments only play a minor role; they range from [0-5%]* to [0-5%]* for BMG (with a weighted average of [0-5%]*) and from [0-5%]* to [0-5%]* for Sony (with a weighted average of [0-5%]*) [The difference between BMG's and Sony's maximum co-op payments was 3.1 percent points]*. According to the data which the Commission received in the course of the procedure for the year 2003, for BMG and Sony the range of invoice discounts for the Top 20 customers was even higher than in 2002 (BMG:[25-30%]*, the weighted average of the invoice discounts amounting to [15-20%]*; Sony: discounts ranging between [10-15%]* and [20-25%]*). Retrospective discounts are used only by BMG for [...]*.

Table 11: Sweden

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Pro forma combined			[25-30%]*	[20-25%]*
EMI	[25-30%]*	[25-30%]*	[20-25%]*	[20-25%]*
Universal	[20-25%]*	[20-25%]*	[15-20%]*	[15-20%]*
Warner	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Total independents	[10-15%]*	[15-20%]*	[20-25%]*	[20-25%]*
- Bonnier Amigo Music	n/a	n/a	[0-5%]*	n/a
- Playground	n/a	n/a	[0-5%]*	n/a
- Marianne	n/a	n/a	[0-5%]*	n/a
- V2	n/a	n/a	[0-5%]*	n/a

Source: Notification / Submission from the Parties

(123) In Sweden, the smaller record labels account for approximately [20-25%]* collectively. **Bonnier** is the largest player, with a [0-5%]* share of the market, followed by **Playground**, **Marianne** and **V2** with shares varying from [0-5%]* to [0-5%]*. Bonnier has its own distribution facilities and provides distribution

services to other independents in Sweden, Norway and Finland, including Marianne and V2. According to the notification, Playground is serviced by key distributor ENS, a joint venture set up by Sony, Universal and EMI.

(124) In Sweden, Sony's top 2 PPDs account for [60-70%]* of its gross sales, the top 5 PPDs for [80-90%]*. BMG's top 2 PPDs account for approximately [70-80%]* of its gross sales, the top 5 PPDs for [90-100%]*. The top PPDs for both BMG and Sony are in a range of 21 cents (BMG: [...]*; Sony: [...]*).

(125) According to the notification, for the year 2002 and for the top 10 customers average invoice discounts range from [15-20%]* to [25-30%]* for BMG and from [5-10%]* to [20-25%]* for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 6.2 percent points and 3.1 percent points for their maximum average invoice discounts]*. Co-op payments only play a minor role; they range from [0-5%]* to [0-5%]* for BMG (with a weighted average of [0-5%]*) and from [0-5%]* to [0-5%]* for Sony (with a weighted average of [0-5%]*) [The difference between BMG's and Sony's maximum co-op payments was 2.4 percent points]*. According to the data which the Commission received in the course of the procedure for the year 2003, the range of invoice discounts for the Top 20 customers was very similar to that for the year 2002 (for BMG:[10-15%]*, with a weighted average of the invoice discounts of [15-20%]*; for Sony from [10-15%]* - [25-30%]* with a range of[10-15%]*). According to the notification only BMG used retrospective discounts for [...]* of the top 5 customers; the amount of the discount was [0-5%]*.

Table 12: Ireland

	2000	2001	2002	2003[62]
BMG	[10-15%]*	[10-15%]*	[15-20%]*	[10-15%]*
Sony	[15-20%]*	[15-20%]*	[15-20%]*	[15-20%]*
Pro forma combined			[30-35%]*	[30-35%]*
Universal	[30-35%]*	[35-40%]*	[20-25%]*	[25-30%]*
EMI	[15-20%]*	[15-20%]*	[20-25%]*	[20-25%]*
Warner	[10-15%]*	[10-15%]*	[10-15%]*	[15-20%]*
Total independents	[0-5%]*	[0-5%]*	[10-15%]*	[0-5%]*

Source: Notification / Submission from the Parties

(126) In Ireland, the independent sector represented some [10-15%]* of the market in 2002. Among those are United Kingdom based **V2, Telstar** and **Mother Records** (founded by U2). According to the notification, distribution in Ireland is generally sourced from the United Kingdom, for example by Sony through TEN - a joint venture with Warner – and by Bertelsmann through Arvato's subsidiary Pinnacle. The main independent distributors in Ireland are RMG Chart Entertainment, Beaumex and Record Services.

(127) In Ireland, Sony's top 5 PPDs account for[60-70* BMG's top 5 PPDS for [80-90%]* of their respective total sales. For both Sony and BMG, the top 2 PPDs, accounting for [30-40%]* and [50-60%]* of total sales respectively, are within a

62 According to the Parties, 2003 figures are based on IRMA estimates.

range of 1 Euro (for BMG EUR [...]* and [...]*, for Sony EUR [...]* and EUR [...]*); the top PPDs for Sony and BMG are in the range of 31 cents.

(128) According to the notification, for the year 2002 and for the top 5 customers average invoice discounts ranged from [0-5%]* to [20-25%]* for BMG and from [5-10%]* to [15-20%]* for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 6.6 percent points and 1.0 percent points for their maximum average invoice discounts]*. Co-op payments are of lesser importance; for the top 5 customers they ranged from [0-5%]* to [0-5%]*for BMG (with a weighted average of [0-5%]*) and from [0-5%]* to [0-5%]* for Sony (with a weighted average of [0-5%]*) [The difference between BMG's and Sony's maximum co-op payments was 2.8 percent points]*. According to the data which the Commission received in the course of the procedure for 2003, the range of invoice discounts for the top 20 customers was similar for BMG and higher for Sony than in 2002 (for BMG from [0-5%]* to [20-25%]* with a weighted average of the discounts of [15-20%]*; for Sony from [5-10%]*to [20-25%]* with a weighted average of [15-20%]*).

Table 13: Austria

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[5-10%]*
Pro forma combined			[20-25%]*	[15-20%]*
Universal	[25-30%]*	[20-25%]*	[25-30%]*	[30-35%]*
EMI	[15-20%]*	[15-20%]*	[15-20%]*	[15-20%]*
Warner	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Total independents	[15-20%]*	[25-30%]*	[25-30%]*	[20-25%]*

Source: Notification / Submission from the Parties

(129) In Austria, the smaller record companies had a [25-30%]* market share in 2002. According to the notification, independent labels include **Musica**, Germany-based **Edel** and **ZYX**, and Bellaphon.

(130) In Austria, Sony's top 5 PPDs account for [60-70%]*, BMG's top 5 PPDS for [70-80%]* of their respective total sales. Two of the respective top 3 PPDs account for [40-50%]* of Sony's total sales and for [30-40%]* of BMG's total sales, and are within a range of EUR 1.50 (for BMG EUR [...]* and EUR [...]*, for Sony EUR [...]* and EUR [...]*).

(131) According to the notification, for the year 2002 average invoice discounts for the top 10 customers ranged from [5-10%]* to [10-15%]* for BMG and from [0-5%]*to [10-15%]* for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 2.6 percent points and 1.0 percent points for their maximum average invoice discounts]*. Co-op payments are of minor importance; for the top 10 customers they ranged from [0-5%]* to [0-5%]* for BMG and are not used by Sony at all. According to the data which the Commission received during the procedure for 2003, the range of invoice discounts for the top 20 customers was higher for BMG and slightly lower for Sony (for BMG: from[5-10%]* to [15-20%]* and for Sony from [5-

10%]* to [10-15%]*). Retrospective discounts ranged from [0-5%]* to [5-10%]* for BMG and from [0-5%]* to [0-5%]* for Sony.

Table 14: Belgium

	2000	2001	2002	2003
BMG	[10-15%]*	[5-10%]*	[5-10%]*	[10-15%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Pro forma combined			[20-25%]*	[20-25%]*
Universal	[25-30%]*	[25-30%]*	[25-30%]*	[25-30%]*
EMI	[20-25%]*	[15-20%]*	[15-20%]*	[20-25%]*
Warner	[5-10%]*	[10-15%]*	[5-10%]*	[5-10%]*
Total independents	[20-25%]*	[15-20%]*	[20-25%]*	[15-20%]*

Source: Notification / Submission from the Parties

(132) In Belgium[63], the smaller independent record companies represented approximately [20-25%]* of the market in 2002. Significant labels include **PIAS** and **V2**.

(133) In Belgium, Sony's top 5 PPDs account for [70-80%]*, BMG's top 5 PPDS for [60-70%]* of their respective total sales. The respective top 2 PPDs, accounting for [40-50%]* of Sony's total sales and for [40-50%]* of BMG's total sales, are the same for both BMG and Sony (EUR [...]* and [...]*).

(134) According to the notification, for the year 2002 average invoice discounts for the top 10 customers ranged from [5-10%]* to [15-20%]* for BMG and from [5-10%]* to [15-20%]*for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 1.9 percent points and 0.4 percent points for their maximum average invoice discounts]*. Co-op payments are of lesser importance; for the Top 10 customers they ranged from [0-5%]* to [5-10%]* for BMG and from [0-5%]* to [0-5%]* for Sony [The difference between BMG's and Sony's maximum co-op payments was 3.5 percent points]*. According to the data which the Commission received during the procedure for 2003, the range of invoice discounts for the Top 20 customers was similar for BMG (from [5-10%* to [20-25%]* with a weighted average of the discounts of [15-20%]*) and for Sony (from [5-10%]* to [20-25%]*, with a weighted average of [15-20%]*). Retrospective discounts were between [0-5%]* and [0-5%]* in 2002 for both Sony and BMG according to the notification.

[63] The figures for Belgium include the figures for Luxembourg as customers in Luxembourg are served by the Belgian operations. Separate figures were not available.

Table 15: Denmark

	2000	2001	2002	2003
BMG	[5-10%]*	[5-10%]*	[5-10%]*	[5-10%]*
Sony	[10-15%]*	[10-15%]*	[15-20%]*	[10-15%]*
Pro forma combined			**[20-25%]***	**[20-25%]***
EMI	[35-40%]*	[30-35%]*	[25-30%]*	[40-45%]*
Universal	[15-20%]*	[20-25%]*	[25-30%]*	[20-25%]*
Warner	[10-15%]*	[10-15%]*	[5-10%]*	[10-15%]*
Total independents	**[10-15%]***	**[10-15%]***	**[10-15%]***	**[5-10%]***

Source: Notification / Submission from the Parties

(135) In Denmark, smaller record companies collectively represented approximately [10-15%]* of the market in 2002. Independent labels include **Bonnier Amigo** and **Edel.**

(136) In Denmark, Sony's top 5 PPDs account for [90-100%]*, and BMG's top 5 PPDS account for [90-100%]* of their respective total sales. The respective top 2 PPDs, accounting for [70-80%]* of Sony's total sales and for [60-70%]* of BMG's total sales, are within a range of 60 cents ([...]* and [...]* for BMG and [...]* and [...]* for Sony).

(137) According to the data received from the Parties during the procedure, invoice discounts for the top 10 customers ranged from [5-10%]* to [25-30%]* for BMG for 2002 and from [5-10%]* to [20-25%]* for 2003 (with a weighted average of [15-20%]*) and for Sony from [5-10%]* to [25-30%]* in 2002 and from [5-10%]* to [30-35%]* in 2003 (with a weighted average of [20-25%]*) [The difference between BMG's and Sony's respective minimum average invoice discounts was 3.3 percent points in 2002 and 1.0 percent points in 2003 and 4.4 percent points for their maximum average invoice discounts in 2002 and 11.6 percent points in 2003]* . Co-op payments are of very minor importance; according to the data supplied by the Parties during the procedure, for the Top 10 customers they ranged from [0-5%]* to [0-5%]* for BMG and from [0-5%]* to approximately [0-5%]* for Sony.

Table 16: Finland

	2000	2001	2002	2003
BMG	[10-15%]*	[10-15%]*	[10-15%]*	[5-10%]*
Sony	[5-10%]*	[5-10%]*	[10-15%]*	[5-10%]*
Pro forma combined			**[20-25%]***	**[15-20%]***
EMI	[10-15%]*	[10-15%]*	[20-25%]*	[15-20%]*
Universal	[10-15%]*	[10-15%]*	[15-20%]*	[15-20%]*
Warner	[15-20%]*	[15-20%]*	[10-15%]*	[10-15%]*
Total independents	**[35-40%]***	**[40-45%]***	**[20-25%]***	**[35-40%]***

Source: Notification / Submission from the Parties

(138) In Finland, smaller record companies had a combined market share of approximately [20-25%]* in 2002. Active independents are **Bonnier** and **Edel,** and a number of other labels, for example Stupido **Records** and the leading independent company in classical music **Ondine** (distributed by a major).

(139) In Finland, Sony's top 5 PPDs account for [90-100%]* and BMG's top 5 PPDs account for [90-100%]* of their respective total sales. The respective top 2 PPDs, accounting for [70-80%]* of Sony's total sales and for [60-70%]* of BMG's total sales, are within a range of approximately 50 cents (for BMG: [...]* and [...]*; for Sony: [...]* and [...]*).

(140) According to the notification, for the year 2002 average invoice discounts for the top 10 customers ranged from [0-5%]* to [20-25%]* for BMG and from [5-10%]* to [20-25%]* for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 6.5 percent points and 1.4 percent points for their maximum average invoice discounts]* . Co-op payments did not play a role for most of the customers; they were substantial (in the range of [5-10%*) for very few of BMG's customers whilst for Sony they ranged between [0-5%]* and [0-5%]* for 2002. According to the data which the Commission received in the course of the procedure for 2003, the range of invoice discounts for the Top 20 customers was similar for BMG (from [0-5%]* to [20-25%]*) and for Sony (from [5-10%]* to [20-25%]*) to that in 2002 [In 2003, the difference between BMG's and Sony's respective minimum average invoice discounts was 7.5 percent points and 5.0 percent points for their maximum average invoice discounts]*. No retrospective discounts were granted in Finland.

<u>**Table 17: Norway**</u>

	2000	2001	2002	2003
BMG	[5-10%]*	[5-10%]*	[5-10%]*	[5-10%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Pro forma combined			[20-25%]*	[15-20%]*
Universal	[20-25%]*	[20-25%]*	[20-25%]*	[20-25%]*
EMI	[15-20%]*	[20-25%]*	[15-20%]*	[20-25%]*
Warner	[10-15%]*	[5-10%]*	[5-10%]*	[10-15%]*
Total independents	[20-25%]*	[20-25%]*	[25-30%]*	[25-30%]*

Source: Notification / Submission from the Parties

(141) Smaller record companies in Norway represent approximately [25-30%]* of the market (2002). Independents include Bonnier Amigo, Playground, MNW and Edel.

(142) In Norway, Sony's top 5 PPDs account for [80-90%]* and BMG's top 5 PPDs account for [90-100%]* of their respective total sales. The respective top 2 PPDs, accounting for [70-80%]* of Sony's total sales and for [60-70%]* of BMG's total sales, are within a range of 60 cents (for BMG: [...]* and [...]*; for Sony: [...]* and [...]*).

(143) According to the notification, for the year 2002 average invoice discounts for the top 10 customers ranged from [10-15%]* to [20-25%]* for BMG and from [15-20%]* to [20-25%]* for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 5.2 percent points and 0.3 percent points for their maximum average invoice discounts]*. Co-op payments may play a role for some customers; for a few of BMG's customers these discounts ranged up to [5-10%]* in 2002, whereas for Sony they ranged up

to [0-5%]* in 2002 according to the data submitted to the Commission during the procedure. According to the data which the Commission received in the course of the procedure for 2003, the range of invoice discounts for the Top 20 customers was similar for Sony to that in 2002 (with a range of [10-15%]*; no data was available for BMG). No retrospective discounts were granted in Norway.

Table 18: Portugal

	2000	2001	2002	2003
BMG	[10-15%]*	[5-10%]*	[5-10%]*	[5-10%]*
Sony	[10-15%]*	[10-15%]*	[10-15%]*	[10-15%]*
Pro forma combined			[15-20%]*	[15-20%]*
Universal	[20-25%]*	[20-25%]*	[20-25%]*	[15-20%]*
EMI	[20-25%]*	[15-20%]*	[15-20%]*	[20-25%]*
Warner	[5-10%]*	[10-15%]*	[5-10%]*	[5-10%]*
Total independents	[25-30%]*	[30-35%]*	[30-35%]*	[35-40%]*

Source: Notification / Submission from the Parties

(144) Smaller record companies active in Portugal in 2002 (approximately a [30-35%]* market share altogether) include **Vidisco, Ovacao, Zona Musica, MVM** and **Som Livre**. Vidisco is the most important independent in Portugal, with a market share of [0-10%] in 2002 and its own distribution facilities. Vidisco lost considerable market share in the year 2003.

(145) In Portugal, Sony's top 5 PPDs account for [80-90%]*, and BMG's top 5 PPDs account for [90-100%]* of their respective total sales. The respective top 2 PPDs, accounting for [60-70%]* of Sony's total sales and for [50-60%]* of BMG's total sales, are within a range of EUR 1.50 (for BMG: EUR [...]* and EUR [...]* ; for Sony: EUR [...]* and EUR [...]*); the top PPDs of both are within a range of EUR 1.00 (EUR [...]* for BMG and EUR [...]* for Sony).

(146) According to the notification, for the year 2002 average invoice discounts for the top 10 customers ranged from [0-5%]* to [20-25%]* for BMG and from [5-10%]* to [20-25%]* for Sony [The difference between BMG's and Sony's respective minimum average invoice discounts was 6.6 percent points and 4.9 percent points for their maximum average invoice discounts]*. Co-op payments play a minor role; according to the notification for the Top 10 customers they ranged from [0-5%]* to [0-5%]* for BMG (and only [...]* out of 10 customers receive them) and from [0-5%]* to [0-5%]* for Sony. According to the data which the Commission received in the course of the procedure for 2003, the range of invoice discounts for the Top 20 customers was similar to that in 2002 for BMG (with a range from [0-5%]* to [20-25%]*) and for Sony (from [5-10%]* to [20-25%]*). According to the notification, retrospective discounts ranged from [0-5%]* to [5-10%]* for BMG and from [0-5%]* to [5-10%]* for Sony.

Table 19: Greece

	2000	2001	2002	2003
BMG	[5-10%]*	[5-10%]*	-	-
Sony	[15-20%]*	[15-20%]*	[15-20%]*	[10-15%]*
Pro forma combined			**[15-20%]***	**[10-15%]***
EMI	[30-35%]*	[30-35%]*	[25-30%]*	[35-40%]*
Universal	[15-20%]*	[15-20%]*	[15-20%]*	[15-20%]*
Warner	[5-10%]*	[5-10%]*	[5-10%]*	[5-10%]*
Total independents	**[15-20%]***	**[20-25%]***	**[30-35%]***	**[20-25%]***

Source: Notification / Submission from the Parties

(147) In Greece, smaller record companies had a market share of [30-35%]* collectively in 2002. Independent labels include **Heaven, Lyra, MBI** and **V2.** BMG was distributed by Sony until 2002 and, since then, has licensed its content to EMI. Consequently, BMG's market share has dropped to zero since 2002. For this reason, no comparison of the Sony and BMG figures is possible.

b. Assessment

(148) On the basis of the foregoing, it can be concluded that the market structure in the smaller national markets is comparable to the market structure in the bigger countries. The market shares are in a similar range. In 2003, the market shares of all the majors ranged from [60-65%]* for Portugal to [95-100%]* for Ireland, in the bigger countries the range is from [70-75%]* (Spain) to [90-95%]* (Italy). The position of the merged SonyBMG would also be in a similar range for the smaller countries: its market shares would range from [15-20%]* (Finland) to [30-35%]* (Ireland), whilst the range is from [20-25%]* (United Kingdom) to [30-35%]* (Italy) in the bigger countries. In the smaller countries, the proposed transaction therefore takes place in relatively similar oligopolistic market structures as in the five large countries.

(149) The use of the PPDs is also quite similar in the smaller national markets. BMG's Top 5 PPDs account for between [60-70%]* (Austria and the Netherlands) and [90-100%]* (Finland) of total sales; Sony's Top 5 PPDs account for between [50-60%]* (the Netherlands) and [90-100%]* (Denmark and Finland) of total sales. The Commission also observes that the use of PPDs shows a considerable parallelism between the majors. As can be seen from the figures stated for each of the smaller countries, for the Netherlands and Belgium the two most important PPDs for both Sony and BMG are virtually identical. For the other smaller countries, the most important PPDs of Sony and BMG are within a range of less than 50 cents, only in Portugal the range may amount to EUR 1 and in Austria to EUR 2. The Commission concludes from these observations that there is also a considerable degree of parallelism between the PPDs of the majors in the smaller countries. Therefore, PPDs could, in the same way as described for the five larger markets, in principle be used by the majors in smaller countries as focal points to align prices.

(150) However, various types of discounts also exist in the smaller countries. As in the larger territories, the most important discounts in all countries are file discounts. As shown for each of the countries, invoice discounts are granted by both BMG and Sony in a considerable range in each of the countries, varying on a customer-

by-customer basis, and the range also differs between BMG and Sony for each of the countries. As these discounts are not standard and are not public knowledge, transparency in the market is reduced and monitoring of the net prices charged by the other majors to customers is made more difficult. Given the relevance and the differences in the discounts, the Commission has not established that there is sufficient evidence to show that a parallelism of average net prices could be ascribed to tacit collusion of the majors, even if there is considerable alignment of PPDs and those PPDs could, in principle, be used as focal point for tacit collusion among the majors. In the same way as discussed for the larger markets, there is not sufficient evidence that these deficits of transparency have been overcome in the past by the monitoring of the retail prices.

(151) Furthermore, discounts are also granted as co-op payments and retrospective discounts. The importance of these discounts varies widely between the different countries, but also varies within countries between Sony and BMG. These discounts could therefore be considered as making tacit collusion between the majors on prices even harder to sustain. However, as already outlined in recital 73, the function of these types of discounts has to be taken into account. As the Parties set out in the notification, it is difficult to assess the "discount" element in such co-operative payments since these payments are made to customers in return for a particular album or campaign being featured in the customer's advertising or marketing. Retrospective discounts ("year end bonuses") are only granted in some countries and their range and their importance does not differ significantly between Sony and BMG within the same country. Furthermore, as the purpose of these discounts is a kind of "loyalty rebate", these discounts do not have an immediate effect on price competition between the majors. However, given that already on the basis of the invoice discounts no sufficient evidence for an existing collective dominance was found, no final conclusion needs to be drawn on the relevance of co-op payments and retrospective discounts.

(152) Furthermore, the considerations relating to homogeneity of the product, transparency of the market and the possibility or the threat of retaliation, as discussed in detail in recitals 110 - 118 for the larger countries, are also valid for the smaller EEA countries. In particular, the Commission has not found evidence of retaliatory action in the past, in the forms as analysed for the large countries, in the smaller national markets.

(153) On this basis, there is not sufficient evidence to conclude that there is an existing collective dominant position of the five majors in the national markets for recorded music of the Netherlands, Sweden, Ireland, Austria, Belgium, Denmark, Finland, Norway, Portugal and Greece.

3. Conclusion on possible strengthening of collective dominance

(154) Given the above, there is not sufficient evidence to establish that the proposed transaction will lead to the strengthening of an existing collective dominant position in the markets for recorded music in any of the EEA countries, as a result of which effective competition would be significantly impeded in the common market or in a substantial part it.

IV. Possible Creation of Collective Dominance in the recorded music markets

(155) The Commission has not found sufficient evidence that the proposed transaction would likely lead to the creation of collective dominance in any of the national markets for recorded music.

(156) The proposed transaction leads to a reduction in the number of major recording companies in each of the national markets –except Greece - from five to four. Whereas in some oligopolistic markets such a reduction of the players may lead to the creation of a collective dominant position for the remaining players, the features of the market are pivotal for the question whether or not such a concentration leads to the creation of collective dominance.

(157) As shown in the analysis as to the strengthening of a collective dominant position, it cannot be concluded from the observable degree of parallelism in average prices that there is an existing collective dominance of the majors in the markets for recorded music. The reduction of the majors from five to four leads to an increase in transparency as the number of bilateral competitive relations goes down from 10 to 6. This in principle would facilitate the monitoring of the respective markets. As discussed in the section on the strengthening of a collective dominant position, the markets for recorded music display certain features which indicate a conduciveness to collective dominance. However, the Commission has not found sufficient evidence that the five majors have held a collective dominant position in the past, in particular due to the deficits in actual transparency, the partly heterogeneous product characteristics and the lack of actual evidence as regards retaliatory action in the past. With respect to the creation of a collective dominant position of the majors in the markets for recorded music, the Commission, while taking into account the general facilitation of co-ordination among the remaining four players, has not found sufficient evidence to prove that the reduction of the majors from five to four represents a change substantial enough to result in the likely creation of collective dominance. In particular, the Commission has not found sufficient evidence that a reduction from five to four majors would facilitate transparency and retaliation to such an extent that the creation of a collective dominant position of the remaining four majors has to be anticipated.

(158) The Commission has therefore come to the conclusion that the concentration is not likely to lead to the creation of a dominant position for the four remaining majors in the markets for recorded music in the EEA countries.

V. Possible Creation of single dominance in recorded music Markets on the basis of vertical relationship to Bertelsmann

(159) Third parties raised concerns that the joint venture would achieve a position of single dominance in the markets for recorded music due to the joint venture's vertical relationship to Bertelsmann's media interest in some Member States, notably Germany, the Netherlands, Belgium, Luxembourg and France. The concerns are based on the consideration that Bertelsmann could use its position in television and radio stations to foreclose competitors and favour SonyBMG, in particular by granting preferential rates to SonyBMG for advertising of artists on

RTL Group's ("RTL") radio and TV stations, by preferring artists from SonyBMG on the radio or TV programme itself, or by completely excluding competitors from advertising or promoting their artists on these channels.

(160) Bertelsmann is the leading free-to-air TV and radio broadcaster in Europe via its control of RTL. In relation to television, RTL's channels with the highest audience shares are in Germany (with an audience share of [20-25%]*), in the Netherlands (with an audience share of [25-30%]*), in the French speaking part of Belgium (with an audience share of [20-25%]*) and in Luxembourg (with an audience share of [10-15%]* for RTL Télé Luxembourg, in addition to an audience share of the RTL's German TV channels of [10-15%]*). As regards advertising revenues, RTL has a share of [35-40%]* in Germany, [35-40%]* in the Netherlands, [65-70%]* in French-speaking Belgium and 80-85% in Luxembourg (Luxembourg channels only). In France, RTL controls the channel M6[64] with an audience share of [10-15%]* and an advertising share of[20-25%]*. In this context it has to be noted that M6 is the most important free-to-air channel for the broadcasting of music in France.

(161) As regards the radio sector, RTL has radio stations with shares of 25% or more of advertising revenues in French-speaking Belgium (with a share of [50-55%]*), France (with a share of [25-30%]*), the Berlin-Brandenburg region in Germany (with a share of [30-35%]*) and Luxembourg (with a share of 70-75%, Luxembourg channels only).

(162) There is some evidence that Bertelsmann has already in the past preferred BMG over competitors. The most important example is the Pop Idol format which is co-owned by RTL. This format has been broadcasted by RTL channels, *inter alia*, in Belgium, France, Netherlands and Germany. In relation to this format, BMG has the right [...]*. Industry experts view BMG's significant increase of market share in the first half of 2003 in Germany as largely a result of hits from artists from the German version of this show. In addition, BMG and RTL also launched a version of a similar show, Fame Academy.[65]

(163) It may therefore be concluded that the advantages derived from a vertical integration in a media group are already incorporated in BMG's market shares for 2003. However, on the basis of these market shares the proposed joint venture does not reach the threshold of single dominance, in particular given that Universal is, by and large, an equally strong competitor in the markets for recorded music in Germany, the Netherlands, Belgium, Luxembourg and France. Furthermore, industry experts expect that such formats have already passed their peak.[66] In addition, the Commission has not found evidence that it could be a profitable strategy for Bertelsmann to exclude competitors from advertising or promoting their artists on the RTL channels.

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64 See Commission decision of 12 March 2004 in Case COMP/M.3330 – RTL/M6.

65 Music & Copyright, No 259, 01.10.2003, p. 9.

66 See for the format *Operación Triunfo* in Spain, Music & Copyright, 18. February 2004, page 12. This is also confirmed by the Parties' submission of 29 June 2004 according to which Vale's market share in Spain has dropped from 21.4% in 2002 to 11.5% in 2003.

(164) The Commission therefore concludes that it is not likely that the proposed joint venture would lead to a single dominant position on the markets for recorded music in Germany, the Netherlands, Belgium, Luxembourg and France.

B. ONLINE MUSIC MARKETS

I. Possible Collective dominance of the majors on the wholesale market for licences for online music

(165) The market for legal online music is currently in a state of infancy. As most of the legal online music sites have only started their operations recently, it is very difficult to definitively determine the market positions of the major recording companies, particularly in relation to national markets. The number of downloaded or streamed songs in the year 2003 was still quite small and not all of the online music service providers obtained licenses from all major record companies at an early stage.[67] Thus, Sony's revenues from online music (subscription and downloading) were quite small; the largest revenues from a single licensee came from [...]* and totalled less than [< EUR 100,000]* until March 2004 for 6 Member States. Sony has also only received revenues from [< 10]* of the [< 20]* licence agreements it currently has with online music platforms in the EEA. A major step for the development of the market seems to have occurred with the launch of Apple's iTunes in the United Kingdom, France and Germany on 14 June 2004. Within the first week, 800,000 songs were downloaded.[68]

(166) The information which the Commission received in the market investigation about the actual downloaded or streamed songs does therefore not appear to give a clear picture of the different players' market positions. In addition, no public industry data is available. However, on the basis of the information which the Commission received, it can be concluded that the market position of the major record companies on the wholesale market for licences for online music appears to be by and large similar to their position on the markets for recorded music. From the figures supplied by Apple for the US iTunes service it may even be concluded that the majors have a bigger stake in this market than in the markets for recorded music.

(167) The Commission found further indications from the agreements provided by the Parties that the prices which the major record companies charge to online providers are in a limited range. Due to the early stage of the market, an analysis of the data on the basis of national markets does not lead to meaningful results. Data collected by the Commission in particular from the Parties indicates that they charge a minimum fee for downloads of frontline tracks of between EUR [...]* and EUR [...]* [difference of EUR 0.25-0.35 between lowest and highest minimum fee charged]*, and for downloads of back catalogue of between

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67 For example, Sony only signed a licence agreement with OD2, the biggest online platform in the EEA up to now, on 24 November 2003.

68 Press release by Apple of 23 June 2004.

EUR [...]* and EUR [...]* [difference of EUR 0.15-0.25 between lowest and highest minimum fee charged]*. The differences are narrower if account is taken of the fact that under several of these agreements [fees include certain other payments due to third parties]*. However, the usage rules under these agreements differ substantially (for example number of burnings on CDs and of transfers to portable devices). As regards subscription services, the majors' licence fees (percentage rates) appear to be quite parallel. Replies in the market investigation stated that prices charged to online music providers are quite high given the fact that in the case of the sale of an online licence no costs for the production and distribution of the physical carrier and the booklet and no obsolescence costs are incurred.[69] The prices charged for albums to the online music providers do not at all seem to reflect these cost savings when compared with the net prices charged to traditional retailers for the sale of CDs. In this respect, it also has to be taken into account that for the sale of online music no returns appear, no cooperative marketing costs are reimbursed (the marketing costs are contractually borne by the online provider) and no discounts are granted.

(168) Given the differences in pricing and usage rules in the current agreements and the emerging state of the online markets, the Commission concludes that currently no sufficient evidence of existing collective dominance can be found on the national markets for licences for online music.

(169) Furthermore, it is also concluded that it is not likely that the proposed joint venture would lead to the creation of a collective dominance of the remaining four majors on the national markets for licences for online music. The reduction from five to four majors leads to increased transparency in the market as the complexity of monitoring the behaviour of the other members of the oligopoly is reduced. In this respect, the transparency in the market for online licences is in any case higher than in the traditional market for recorded music. Discounts play, if at all, only a minor role, much fewer retailers are active in the market and the Internet facilitates a systematic monitoring of retail prices. However, given the emerging state of the market and the current structure of prices and usage conditions, which appear to be in flux in correspondence to the developing state of the market, it is concluded that the reduction of the majors from five to four would not increase transparency and the possibility to retaliate to such an extent that this would be likely to lead to the creation of a collective dominant position.

(170) The Commission has therefore come to the conclusion that the concentration is not likely to lead to the creation of a dominant position of the four remaining majors in the markets for licences for online music in the EEA countries.

II. Possible single dominance of Sony Connect in the markets for distribution of online music

(171) Third parties raised concerns that, as a result of the proposed transaction, Sony could obtain a position of single dominance on the national markets for

[69] According to data provided by the Parties, these costs account for approximately [15-20%]* to [20-25%]* of total costs.

distribution of online music via its Sony Connect music downloading service. These concerns were based on the consideration that Sony could use the control of the joint venture to foreclose competitors in the downstream market for distribution of online music, in particular by denying competing online platforms access to the SonyBMG library or by engaging in discriminatory behaviour vis-à-vis its competitors as regards usage rules, time of release of new songs, format in which the tracks are to be downloaded, etc. Although SonyBMG would not dominate the market for licensing of digital music, there are concerns that SonyBMG's bargaining power would be greatly increased by the large accumulation of catalogue and the general need of music downloading services to offer music from all the majors.

(172) The incentive for such a foreclosure would in particular follow from Sony's activity in digital (portable) music players. Sony – on the basis of its proprietary compression/decompression ("codec") format – Atrac - and its proprietary digital rights management system ("*DRM*") – Open MusicGate – would have the ability to offer music only in formats which cannot be read by devices using competing formats and DRMs, such as Apple's iPod or devices using Microsoft's codec format and DRM. Sony could thereby use its position in content – via the joint venture – to become dominant in the market for downloading services and thereby boost the sale of its own (portable) music players. The strategy to increase the sale of portable music players by offering a downloading service adapted to the format of the specific player has been successfully adopted by Apple with the iPod and the iTunes music store.

(173) However, Sony Connect has only been launched in Europe at the beginning of July 2004 in France, Germany and the United Kingdom, after having been launched in the US in May 2004, and therefore currently does not have a share of the market. Other players have already gained a certain position in the market and further players have announced that they would enter the market. The most important platform for distribution of online music in Europe has been OD2 up to now, also the only one operating on a pan-European basis. Due to their large base of retailers, under whose names they operate, they may also in the future have a considerable advantage in the markets. Apple started its iTunes music store in the United Kingdom, France and Germany in June 2004 and has announced that it sold over 800,000 downloaded songs in the first week, many times more than its competitors.[70] It has a further advantage on the basis of its strong US-operations where it has, according to its own calculations, reached a market share of over 70%[71]. Other strong players have entered or are about to enter the markets in the EEA, such as Napster, RealNetworks and Microsoft (currently using OD2 in the United Kingdom).

(174) Furthermore, by foreclosing competitors, the proposed joint venture SonyBMG would forego considerable licence revenues for the tracks sold by competing platforms. It appears very doubtful whether this could be a profitable strategy.

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[70] Apple press release of 23 June 2004.

[71] Apple press release of 28 April 2004.

(175) Given the above, the Commission has therefore come to the conclusion that it is not likely that Sony will achieve a position of single dominance in the national markets for online distribution of music.

C. POSSIBLE SPILL-OVER EFFECTS IN MUSIC PUBLISHING

(176) Pursuant to Article 2(4) of the Merger Regulation, to the extent that the creation of a joint venture constituting a concentration pursuant to Article 3 has as its object or effect the co-ordination of the competitive behaviour of undertakings that remain independent, such co-ordination is to be appraised in accordance with the criteria of Article 81(1) and (3) of the Treaty, with a view to establishing whether or not the operation is compatible with the common market. A restriction of competition under Article 81(1) of the Treaty is established when the co-ordination of the parent companies' competitive behaviour is likely and appreciable and results from the creation of the joint venture.

(177) According to the notification each Party will retain and continue to operate its music publishing interests independently of the joint venture, Bertelsmann via BMG Music Publishing and Sony via Sony/ATV Music Publishing, a joint venture jointly controlled by Sony and the artist Michael Jackson. The music publishing markets, in particular with respect to the exploitation of mechanical rights, are upstream from the music recording market and therefore closely linked to the activities of the proposed joint venture.

Likelihood of coordination

(178) There is no evidence that the joint venture would have as its object the co-ordination of the Parties' competitive behaviour in music publishing. Since the publishing business may supply an important input for the music recording business, there is, however, the risk that the creation of the joint venture would have as its effect the co-ordination of the Parties' competitive behaviour in music publishing.

(179) However, even if Sony and Bertelsmann were to coordinate the behaviour of their respective publishing businesses, such coordination could only materialize to a rather limited extent since the administration of the publishing rights is mainly carried out by the collecting societies (at least for the, in terms of revenue, by far most important mechanical and performance rights). Also the royalties are fixed by the collecting societies in agreement with publishers and authors and composers. Consequently, there is little room for the Parties to coordinate. Furthermore, under the current agreements with the collecting societies and the laws regulating the sector, the collecting societies grant licenses for the mechanical exploitation on a non-discriminatory basis. Also in this respect there is no room for co-ordination of the Parties' competitive behaviour in music publishing.

(180) Some third parties have argued that there would be a tendency of the majors to by-pass the collecting societies in the future by exploiting the publishing rights by themselves. First, if the majors were to by-pass the collecting societies in the future, it could hardly be argued that this could be a result of this concentration.

Furthermore, this line of argument currently appears rather speculative since there are – at least at the moment – no concrete indications that the parent companies and the other majors will pursue such a strategy. This appears to be all the more the case as the approval of the authors and composers would be needed by the publishers for such a step.

(181) As third parties have mentioned the joint attempt of the majors to currently decrease the amount of royalties for mechanical rights (for example the attempt to decrease the level of mechanical royalties by initiating a proceeding in front of an arbitration panel of the *Bundespatentamt*), it should be noted that this is an action of the recording companies and not of the publishing companies.

(182) It is therefore concluded that the creation of the proposed joint venture is not likely to have as an effect the coordination of the competitive behaviour of Sony's and Bertelsmann's publishing businesses.

D. CONCLUSION

(183) For the reasons set out above it must be concluded that the proposed concentration does not create nor strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it, and that it does not restrict competition within the meaning of Article 2 (4) of the Merger Regulation and Article 81 of the Treaty. The concentration is therefore to be declared compatible with the common market pursuant to Article 8(2) of the Merger Regulation and with the EEA Agreement pursuant to Article 57 thereof.

HAS ADOPTED THIS DECISION:

Article 1

The notified operation whereby Sony Corporation of America and Bertelsmann AG acquire joint control, within the meaning of Article 3(1)(b) of Regulation (EEC) No 4064/89, of the newly created joint venture SonyBMG is hereby declared compatible with the common market and the functioning of the EEA Agreement.

Article 2

This Decision is addressed to:

Bertelsmann AG
Carl-Bertelsmann-Straße 270
D-33311 Gütersloh
Germany

Sony Corporation of America
550 Madison Avenue

10022 New York, NY
USA

Done at Brussels, 19/07/2004

For the Commission

signed
Mario MONTI
Member of the Commission

EUROPEAN COMMISSION
Competition DG

Policy and Strategic Support

Brussels, 9 July 2004

OPINION OF THE ADVISORY COMMITTEE ON CONCENTRATIONS GIVEN AT ITS 127TH MEETING ON 9 JULY 2004 CONCERNING A PRELIMINARY DRAFT DECISION IN CASE COMP/M.3333-SONY/BMG

1. The Advisory Committee agrees with the Commission that the notified operation constitutes a concentration within the meaning of the Merger Regulation (EEC) No 4064/89 and that it has a Community dimension as defined by that Regulation.

2. The Advisory Committee agrees with the Commission that there is a relevant product market for:

   a) recorded music, which might be subdivided into separate markets for different genres and for compilations,

   b) online music divided into the wholesale market for licenses for online music and the retail market for distribution of online music,

   c) music publishing, which might be subdivided into separate markets for mechanical rights, performance rights, synchronisation rights, printing rights and other rights.

3. The Advisory Committee agrees with the Commission that the above product markets are national in scope except for music publishing where the geographic market can be left open.

4. The majority of the Advisory Committee agrees with the Commission that the proposed concentration will not lead to the strengthening nor the creation of a collective dominant position in the markets for:

   a) recorded music or

   b) the wholesale market for licenses for online music.

   A minority disagrees.

Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium.
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E-mail: COMP-MEETINGS@cec.eu.int

5. The Advisory Committee agrees with the Commission that the proposed concentration will not lead to the creation of a single dominant position in:

   a) the markets for recorded music in Germany, the Netherlands, Belgium, Luxembourg and France and

   b) the national markets for online music distribution.

6. The majority of the Advisory Committee agrees with the Commission that the proposed concentration will not have as an effect the coordination of the competitive behaviour of Sony and Bertelsmann in the music publishing markets. A minority disagrees.

7. The majority of the Advisory Committee agrees with the Commission that the proposed concentration does not create nor strengthen a dominant position as a result of which effective competition would be significantly impeded in the Common Market or in a substantial part of it and that the concentration therefore is to be declared compatible with the Common Market and with the EEA Agreement. A minority disagrees.

8. The Advisory Committee recommends publication of its opinion in the Official Journal of the European Union.

9. The Advisory Committee asks the Commission to take into account all the other points raised during the discussion.

BELGIË/BELGIQUE	**ČESKÁ REPUBLIKA**	**DANMARK**	**DEUTSCHLAND**	**EESTI**
J. COMPERE	—	—	I. MECKE	—
ELLADA	**ESPAÑA**	**FRANCE**	**IRELAND**	**ITALIA**
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KYPROS/KIBRIS	**LATVIJA**	**LIETUVA**	**LUXEMBOURG**	**MAGYARORSZÁG**
—	—	—	—	—
MALTA	**NEDERLAND**	**ÖSTERREICH**	**POLSKA**	**PORTUGAL**
—	G. ESTERUELAS BERLINGUER	A. LUKASCHEK	M. KUPCZAK	—
SLOVENIJA	**SLOVENSKO**	**SUOMI-FINLAND**	**SVERIGE**	**UNITED KINGDOM**
—	—	P. ASPINEN	N. WAARDAHL	A. EKPIKEN

EUROPEAN COMMISSION

The Hearing Officer

FINAL REPORT OF THE HEARING OFFICER
IN CASE COMP/ M.3333 –SONY/BMG

(pursuant to Article 15 of Commission Decision 2001/462/EC, ECSC of 23 May 2001 on the terms of reference of hearing officers in certain competition proceedings – OJ L 162, 19.6.2001, p. 21)

The draft decision gives rise to the following observations:

Written procedure

It is recalled that on 9 January 2004 the undertakings Bertelsmann AG ("Bertelsmann") and Sony Corporation of America belonging to the Sony group, Japan ("Sony"),[72] notified the merger of their global recorded music businesses to the Commission under Article 4 of Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings[73] ("the Merger Regulation").

By decision of 12 February 2004 the Commission initiated proceedings pursuant to Art. 6(1)c of the Merger Regulation.

The procedure was suspended from 7 April until 5 May 2004 pursuant to Art. 11(5) of the Merger Regulation as the parties had not fully responded to a request for information.

A statement of objections ("SO") was sent to the notifying parties on 24 May 2004.

The notifying parties were asked to reply by 9 June 2004. This deadline was complied with.

---

72 both refered to hereinafter as "the notifying parties".

73 OJ L 395, 30.12.1989, p.1; corrigendum, OJ L 257, 21.9.1990, p. 13. Last amended by Regulation (EC) No 1319/97 (OJ L 180, 9.7.1997, p.1; corrigendum, OJ L 40, 13.2.1998, p. 17.

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Access to file

Access to the file was granted to the notifying parties on 19 May 2004.

Subsequent to a meeting between myself, the representatives of the notifying parties and the case team which took place on 1 June 2004, I granted access to additional information in the Commission's file.

In order to allow the economists of the notifying parties to access third parties' confidential data in the Commission's data room, the economists signed a confidentiality declaration, the contents of which had been approved by Universal Music international, Warner Music Group and EMI Group. By mutual consent with the notifying parties and the third parties, I controlled compliance with this clause.

Finally, the notifying parties were granted further access to the file on 10 June 2004, when they were provided with the non-confidential version of the documents submitted by the European Broadcasting Association and Apple Computer Inc.

Involvement of third parties

I admitted the following undertakings as third parties according to Article 11 (c) of Commission Regulation (EC) No. 447/98: Apple Computer Inc., Universal Music International, Syndicat des Détaillants Spécialisés du Disque and Union des Producteurs Phonographiques Français Indépendants, European Consumer's Organisation, European Broadcasting Union, Playlouder, IMPALA, International Music Managers Forum, the Swedish Society of Popular Music Composers, EMI group, Warner Music Group, Time Warner Inc. In order to inform them of the nature and subject matter of the procedure, pursuant to Article 16 of Commission Regulation (EC) No. 447/98, DG Competition sent them a non-confidential version of the SO.

Oral hearing

An oral hearing took place on 14 and 15 June 2004.

Most of the third parties that had taken part in the procedure also participated in the oral hearing.

EMI Group and Warner Music Group requested to be admitted as observers to the oral hearing. As I had already informed both companies before in writing, I take the view that hearings are not occasions in which interested third parties are allowed to attend without participating actively. Therefore, their admission was contingent on their willingness to present their views in the hearing. Since they were not in a position to do this, they could not be admitted.

Notwithstanding their non-admission to the oral hearing, I consider that both companies, as well as the other third parties, have had sufficient possibilities to participate in the ongoing proceedings and to ensure that their views are known by the Commission services. All third parties have had the opportunity to obtain an in-depth knowledge of the issues raised by the case in the course of the procedure; some third parties made comprehensive contributions to the Commission analysis undertaken both before the issuing of the SO and after having received the non confidential version of the SO.

Taking into account the replies of the parties to the SO and their explanations given at the oral hearing, DG Competition has concluded that the objections which it had set out in the SO did not stand.

In the light of the above, I consider that the rights to be heard of all participants to the present proceeding have been respected.

Brussels, 13 July 2004.

(signed)

Serge DURANDE

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To Michael Pelcovits		Date 12/28/05	# of pages 4
Co./Dept. Micra, Inc.		From Alex Belinfante	
Phone # 417-2513		Co. FCC	
Fax # 296-5694		Phone # 418-0744	
		Fax # 418-4595	

ESTIMATING THE DEMAND FOR RECORD ALBUMS

Alexander Belinfante and Reuben R. Davis, Jr.*

Because of the great importance of taste as a determinant of demand for phonograph records, little work has been done in the area of estimating their demand. This study introduces a way of measuring the taste for popular record albums, thus permitting an estimation of their demand by using multiple regression analysis. Taste was measured through the performance of singles taken from the album. Combined with this taste variable were the status of the artist, exposure by radio play and concerts, and submarket appeal. These were found to be statistically significant variables and provided an apparently valid model for estimating demand.

An attempt was also made to estimate the price elasticity of demand in order to judge whether recently instituted price increases can be justified. (A 1977 trade publication article[1] indicated a concern by the record industry regarding the importance of the price variable.) Price was found to be of minor importance and in the inelastic range.

The Sample. All of the data for this study came from *Billboard* magazine. The sample consisted of 141 record albums which appeared on the *Billboard* Top LPs chart in the first half of 1977. The sample consisted of all albums which fell off this chart between April 23 and July 9, 1977, except for the following, which were excluded: 1) all "greatest hits" albums, which are compilations of material previously released on other albums; 2) other reissues of previously released material; 3) all "live" albums, which are generally live concert performances of material previously released in studio-recorded versions; 4) all albums that returned to the charts after July 2; and 5) all albums which first entered the charts before 1976. The last group was excluded because data on one of the variables (radio play) were not available before late 1975 and because the list price on some of these albums was changed since their initial release.

The Variables. The dependent variable, QA, in our demand equation is an estimate of the quantity of records sold. Since actual sales data are not readily available, the chart performance of the albums on the *Billboard* Top LPs chart (which consists of 200 records per

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[1] "Dealers, Customers Gripe but Accept $1 LP Price Rise," *Billboard*, May 7, 1977, pp. 1, 10, 12, 14, 77, 85, 90.

week) was used instead. This performance was measured by taking 201 minus the chart position, summed over all weeks for which the album appeared on the chart.[2] (Thus the number 1 album gets a value of 200 and the number 200 album gets a value of 1, etc.) Although these charts are estimates of relative, not absolute, sales performance, a source in the industry[3] has estimated that the correlation between chart performance and actual sales is about .9, indicating that QA provides a reasonably good estimate of sales. The range of observed values of QA was from 2 to 7865, with a mean of 1199.

The independent explanatory variables in our model were chosen to estimate the following factors affecting demand: taste, artist status, exposure, submarket appeal, and price. All of these variables except price were expected to have a positive effect on sales. Price was expected to have a negative effect on sales, in accordance with a usual downward-sloping demand curve.

Taste was measured by QS, the performance on the *Billboard* Hot 100 singles chart of 45 rpm singles taken from the album. Performance on this chart (which consists of 100 records per week) was measured by taking 101 minus the chart position, summed over all weeks for which the single appeared on the chart. If more than one single was taken from the album, QS is the sum of the chart performances of all of the singles. Since these singles are excerpts from the album, their sales can be taken as an indication of the appeal of the music in the album to the public. Many of those who buy albums do so because they contain these popular singles. The range of observed values of QS was from 0 to 4023, with a mean of 346.

Artist status was measured by QP, the performance of the artist's most recent previous album (disregarding "greatest hits" albums) on the Top LPs chart. This was measured in the same way as QA.[4] It is taken as an indication of the popularity of the artist. Some of those who buy albums do so because they liked the artist's previous album. The range of observed values of QP was from 0 to 13813, with a mean of 1392.

[2] Because no issue of *Billboard* was published for the week of January 1, 1977, the chart positions for that week were assumed to be the same as for the previous week.

[3] Thomas F. Dunne, Capitol Records, Inc., private communication.

[4] In two cases where the previous album was still on the chart when the sample album fell off, the summing of the chart performance for QP was stopped at the time the sample album fell off the chart.

Exposure was measured by RC, the total number of mentions in the *Billboard* Album Radio Action regional listings under the categories "top add ons," "top request/airplay," and "breakouts," plus the number of live concert appearances listed in the *Billboard* Top Box Office charts during the weeks the album was on the charts. This is an indication of the extent of radio play the album received on the radio stations surveyed, which are mainly FM album-oriented rock stations, and the additional exposure of the artist in live concert appearances. Many of those who buy albums do so because they heard the album (or selections from it) on the radio or saw the artist in concert. The radio play and concert totals were originally included as separate variables, but since their coefficients were approximately equal and since there was some multicollinearity between the variables, it was decided to combine them into one variable. The range of observed values of RC was from 0 to 41, with a mean of 5.9.

Submarket appeal was measured by SU, the number of submarkets for which the album appeared on the *Billboard* submarket album chart or for which singles from the album appeared on the submarket singles chart. The submarkets included in this variable are country, soul, jazz, easy listening, and disco. These submarkets are for different types of music than that primarily programmed by the radio stations included in the variable RC. No attempt was made to compute the performance on these submarket charts, because sales of the records in these submarkets constitute part of the total sales of the records, measured by QA and QS. Originally, separate "dummy" variables were tried for each of these five submarkets. However, the coefficients for the five submarket variables were of similar magnitude, and the overall fit was better when SU was used. Thus it was decided to combine the five categories into one variable. The range of observed values of SU was from 0 to 3, with a mean of 0.9.

Price was measured by PR, the list price of the album. Even though there normally is discounting at the retail level, the sales prices in any one location are generally approximately proportional to the list prices. Thus percentage variations in actual sales prices (used in computing elasticities) are generally about the same as percentage variations in list prices. The observed values of PR were 6.98 and 7.98, with a mean of 7.04.

The Estimates. The model which was estimated is: $QA = b_0 + b_1QS + b_2QP + b_3RC + b_4SU - b_5PR$. The estimated equation is:

$$\underset{(0.29)}{QA = 457.7} + \underset{(12.61)}{1.112\ QS} + \underset{(7.10)}{0.2043\ QP} + \underset{(8.46)}{65.32\ RC} + \underset{(5.19)}{344.2\ SU} - \underset{(0.40)}{88.30\ PR.}$$

The numbers in parentheses are the t-statistics for the coefficients. A t-value of greater than 1.65 indicates that the coefficient is significantly different from zero for a one-sided test at the .05 significance level. The coefficient of determination, $R^2 = .824$, indicates that most of the variation in QA has been explained by this regression. Nevertheless, the residual variation is still moderately large, as indicated by the standard error of estimate, $s = 618.02$. (This, though, is only about 8% of the range of observations for QA.) All the coefficients have the expected sign. However, since the coefficient of PR was not significantly different from zero, the equation was re-estimated, dropping that variable. The results are:

$$QA = \underset{(1.79)}{-166.3} + \underset{(12.70)}{1.115\ QS} + \underset{(7.20)}{.2019\ QP} + \underset{(8.51)}{65.45\ RC} + \underset{(5.34)}{348.4\ SU.}$$

$R^2 = .824$ and $s = 616.11$. The coefficients of all of the variables are similar in both regressions. The only noteworthy change is the shift in the intercept from positive to negative. The positive intercept in the first equation is an estimate of QA when a record's price is reduced to zero and all the other independent variables are also zero. The negative intercept in the second equation can be interpreted as being a result of the fact that a 0 value of QA does not necessarily correspond to zero sales. Thus the intercept can be thought of as an estimate of the degree of "backward extrapolation" of the charts needed to reach zero sales.

As expected, the variable introduced to measure taste, QS, proved to be the most significant one in the model, as is shown by its t-value. This also indicates the importance of the use of singles as a way of promoting the sales of an album. The second most significant variable was RC, revealing the importance of radio play and live concerts in giving exposure to a record. The third most significant variable was QP, taken as a measure of the artist's popularity. As might be expected, the coefficient of this variable is substantially less than one, suggesting that a follow-up album can be expected to sell only about one-fifth as well as the previous album in the absence of any other stimulus to sales. Next in significance was SU, indicating the importance of submarket appeal. This also reflects the importance of the "cross-over" effect of the appeal to more than one submarket, which is often discussed in the record industry. Price, PR, does not seem to be a significant detriment to sales, reinforcing the opinion of some in the industry that "the public will pay for what it wants, even though it may bitch about the higher cost."[5]

The Price Elasticity. Although the coefficient of price in the first equation above is not very reliable (as indicated by its low t-value), it is of some interest to consider the implications of this coefficient. First, the price elasticity of demand at the means can be estimated by multiplying the coefficient by the ratio of the mean values of PR and QA.[6] In this case, the elasticity estimate is $b_5 \frac{\overline{PR}}{\overline{QA}} = 88.30 \frac{(7.04)}{(1199)} = .52$. Of course, the price elasticity for a linear demand curve (as we have here) is not constant. Since the estimated elasticity is less than one at the means, this indicates that revenues (and profits) could be increased by raising the price of albums of at least average demand to the point where the price elasticity is one. This point can be determined by finding the demand equation that corresponds to the average values of the other variables, solving for the equation with the slope b_5 which goes through the point whose coordinates are the mean values of PR and QA or, alternatively, substituting the mean values of QS, QP, RC, and SU into the first of the above estimated equations. In either case, the estimated equation is $QA = 1821 - 88.30PR$, or, solving for PR, $PR = 20.62 - .01133QA$. The point where elasticity is one is the midpoint, where $PR = 10.31$ and $QA = 911$. However, since our estimate of b_5 is not very reliable and since \$10.31 is well above the highest price observed in our sample, it would probably be unwise to immediately raise prices to that level. But the recent introduction of several albums of expected high demand at a list price of \$7.98 instead of the previously prevailing list price of \$6.98 seems justified in view of the goal of profit maximization. (Some of these higher priced albums were included in our sample.) This justification is reinforced by the relative insignificance of the coefficient of price in the estimated demand equation.

[5] *Billboard, op. cit.*

[6] Since b_5 is the estimate of the change in QA caused by a one-unit change in PR, i.e., $\Delta QA/\Delta PR$.

However, the regression results do not justify an across-the-board list price increase on all albums. Although the price coefficient is not significant, it is still negative, indicating that price may well have at least some detrimental effect on sales, which could be important for albums of less than average demand. Specifically, the formula for the price elasticity, $b_4 \frac{PR}{QA}$, can be set equal to one and solved for $QA = b_4 PR$ to find the demand level (resulting from different values of the other variables QS, QP, RC, and SU) which would result in revenue maximization for any given price. For a list price of $7.98, this is $QA = 88.30\ (7.98) = 705$. Thus, for albums with an anticipated demand of less than $QA = 705$, a list price of $7.98 could result in some revenue loss. (Since profit maximization generally occurs at a slightly higher price and lower quantity than revenue maximization, a slightly lower anticipated demand could be consistent with profit maximization at a list price of $7.98). More widespread use of variable pricing, instead of the historical practice of a uniform list price, seems justified.

It is also of some interest to compare the above estimate of average price elasticity with an industry estimate[7] made when there was an across-the-board list price increase from $5.98 to $6.98. This 16.7% price increase resulted in an estimated loss of unit sales of 14%, corresponding to an elasticity of about .84, which is .32 larger than the above estimate.[8] All of the discrepancy could be attributable to the unrealiability of the estimated price coefficient in the regression. However, there are also other reasons to expect a difference between the two estimates. Probably the most important is that the measure of sales used in this study is a measure of relative sales, while absolute sales were used in the industry estimate. Thus, the regression estimate can be expected to reflect only the substitution effect of the price increase on demand, and not the income effect. The loss of "real" income resulting from the higher price would tend to depress total unit sales of all records, in addition to the estimated impact on relative sales. On the other hand, the industry estimate takes both effects into account by the use of actual unit sales. Another possible factor is that there may be some simultaneous equations bias in the regression estimate due to the interaction between supply and demand. However, since the list prices generally remain fixed in the face of fluctuating demand, and since the simple correlation between PR and QA or QP is not significantly different from zero, the magnitude of this bias is probably minor.

[7] Dunne, *op. cit.*

[8] A minor difference is that the above regression estimate is a point elasticity, while the industry estimate is an arc elasticity.

Conclusions. The model introduced above seems to be useful in the study of demand in this industry. The following policy implications seem warranted: In view of the significance of QS and RC, the emphasis currently prevailing in the industry towards promoting records through quality rather than price seems justified. Specifically, the promotion of albums through the release of singles from the album, attempts to get radio play, and encouraging artists to tour when their albums are released are important ways of increasing the sales of the album. Thus, for example, record company subsidies of artists' tours that coincide with album releases can be expected to pay off in increased sales. Since price does not appear to be a significant detriment to sales, selected price increases for high demand albums should increase profits. A variable pricing policy (charging different prices for different albums) is recommended.

Although the regression estimates seem reasonably satisfactory, there are ways the results could have been improved through the use of more or better data. These include the following:

(1) The use of actual sales data (instead of chart performance) would make the results more trustworthy.

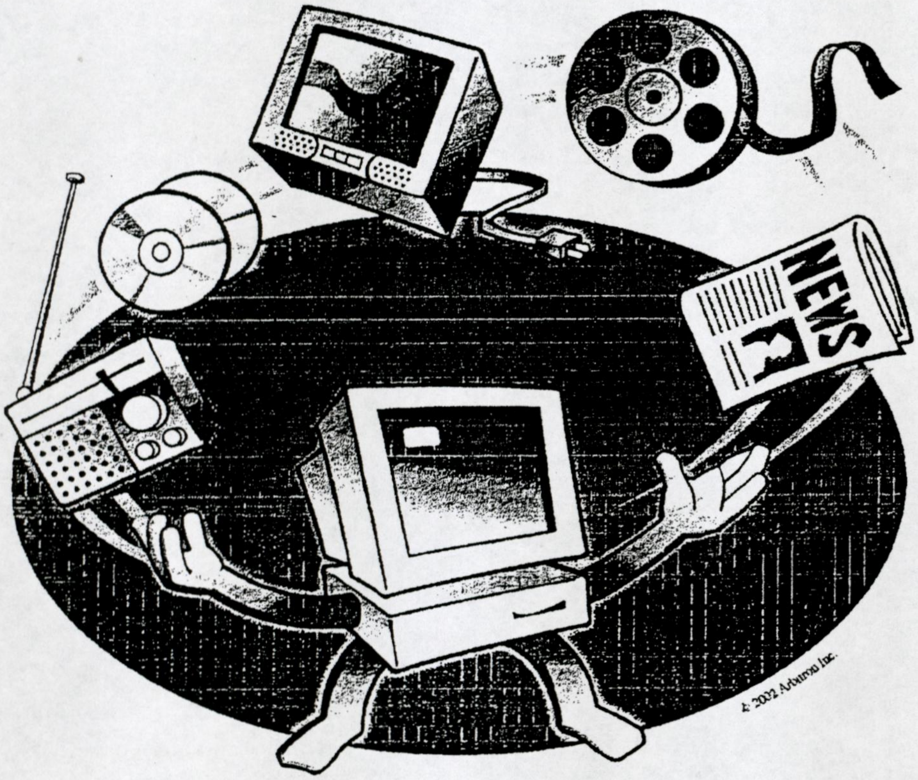
(2) A more comprehensive survey of radio stations with a wider variety of formats would probably make radio play an even more significant variable and might well eliminate the need for the submarket variable. Ideally, the reports of the radio stations should be weighted by the size of their listening audience. The kind of information used by the performing rights organizations (ASCAP and BMI) to determine royalty payments might be useful.

(3) A substantially larger sample would be needed to get more reliable estimates of the true impact of price change on sales.

Arbitron/Edison Media Research

Internet 9:

The Media and Entertainment World of Online Consumers



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ARBITRON   edison media research

Overview

Welcome to the ninth Arbitron/Edison Media Research study of consumers' use of streaming media and the Internet, with brand-new data from interviews conducted in July 2002. We have conducted these studies every six months since August of 1998, and our semiannual reports have become widely used sources of information on streaming media and consumer behavior on the Internet.

In the first half of 2002, streaming media faced a period of tremendous turmoil and controversy. Several webcasters ceased streaming due to newly imposed digital-rights fees. For the first time, the number of Americans having listened to audio or watched video online in the past month did not grow significantly from year to year (37 million in July 2001 to 38 million in July 2002). The number of Americans having listened to or watched webcasts in the past week is also flat during that same period (an estimated 19 million in both July 2001 and July 2002). While there is a lack of significant growth, in light of the discontinuation of many webcasts, the fact that large numbers of Americans continue to use streaming media indicates the continued popularity of Internet audio and video.

Overall, 35% of Americans age 12 and older are "Streamies"—Internet users who have ever listened to audio or watched video online. This translates into approximately 83 million Americans. In a typical month, 23% of those online use Internet audio or video.

Despite the struggling economy during the past year and a half, consumer adoption of superfast Internet broadband connections continues to rise sharply. The proportion of online Americans who report having residential broadband Internet access surged to 28% in July 2002, up from 13% eighteen months earlier (January of 2001). Those with broadband connections see the Internet as far more essential and consume a lot more streaming media, especially video webcasts, compared to those with slower, dial-up connections.

This report outlines key findings detailed in a point-by-point manner and also includes recommendations. We have also included several appendices to enhance readers' understanding of American consumer use of the Internet and streaming media. Appendix A depicts topline metrics for streaming media. Appendix B profiles Internet users, total Streamies and active Streamies (those who have listened or watched online in the past month or past week). Appendix C shows a comparison of Internet users with dial-up access and those with broadband access.

How the Study Was Conducted

A total of 2,511 people were surveyed to investigate America's Internet usage and streaming media behavior. In July 2002, telephone interviews were conducted with respondents age 12 and older chosen at random from a national sample of Arbitron's Spring 2002 survey diarykeepers.

Significant Highlights

- **After years of rapid growth, the proportion of Americans with access to the Internet has leveled off.** Internet access in any location has stabilized at seven in ten Americans. Despite the slowing growth of Internet adoption, the average daily time spent online continues to increase steadily.

- **Americans continue to adopt superfast at-home broadband Internet connections despite the slowing economy.** The number of Americans with broadband connections at home has more than doubled since January 2001. At the beginning of 2001, 13% of those with at-home Internet access subscribed to broadband. As of July 2002, 28% of those with access to the Internet at home have a broadband connection. It appears that broadband adoption will continue to grow. One out of five of those with dial-up home Internet access indicate an intention to convert to broadband in the coming year.

- **Despite the turmoil in the streaming media sector, record numbers of Americans continue to consume Internet audio and video.** While a number of radio stations and webcasters have ceased streaming due to newly imposed government digital-rights fees, streaming continues to hold the attention of the American consumer. Approximately 83 million Americans have now experienced Internet audio or video. The number of people who have listened to audio or watched video online in the past month grew slightly from the prior year (37 million in July 2001 to 38 million in July 2002).

- **Streamies are upset about new digital-rights fees that threaten webcasting, and they support congressional action.** Among those who stream on a weekly basis, half are aware of the digital-rights controversies that have caused several webcasters to cease streaming. Two-thirds of monthly Streamies indicate they are upset about not being able to listen to canceled Internet audio webcasts, and a similar number support action by Congress to help Internet audio webcasts afford to continue streaming.

- **Streamies are more aware of online audio commercials.** Consumer awareness of online audio commercials in Internet webcasts has increased from 30% in July of 2001 to 40% in July 2002. Consumers see streaming ads as far more acceptable than traditional Internet banner advertising and a fair trade-off for free online streaming content.

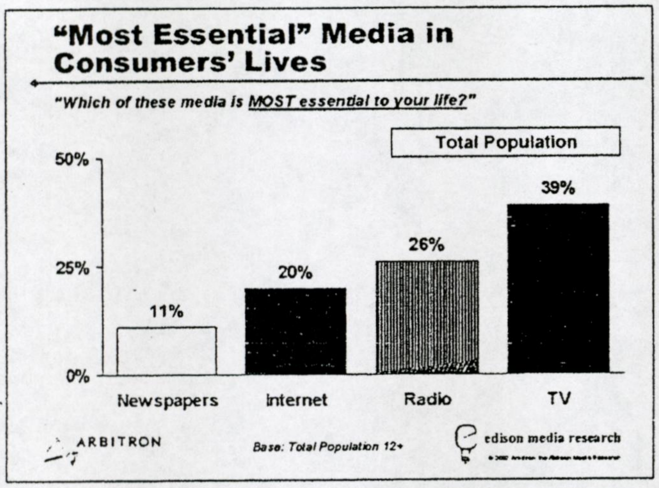
- **An estimated 16 million Americans say they would be willing to pay a small fee to listen to the online audio content provided by the webcast audio channel that they listen to most.** More than one out of five Internet audio Streamies (22%) indicate they are interested in paying for streaming subscription content. Thus, not only is there a compelling argument to be made for streaming media advertising, there is a significant interest among consumers in streaming subscription models.

- **Habitual consumers of webcasting buy the most recorded CDs.** The data show that those who stream the most also buy the most CDs. The average American purchased 13 CDs in the past year. Consumers who have ever tried streaming purchased 15 CDs in the past year, consumers who have streamed in the last month bought 18 CDs, and those who streamed in the last week bought 21 CDs in the last year. Thus, the data imply that more active streaming media users are a very lucrative group of record buyers.

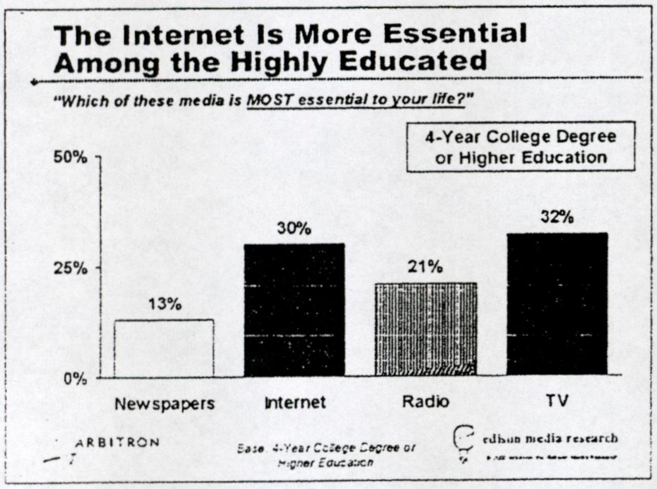
Key Findings

A. Media and Entertainment Patterns of Online Consumers

1. **When compared with other traditional media, one out of five Americans feel the Internet is "most essential" to their life.** When asked to indicate which medium among TV, radio, the Internet and newspapers is "most essential," 39% of all Americans indicate television, followed by radio (26%) and the Internet (20%). Eleven percent indicate newspapers as most essential. Considering how new the Internet is compared to TV, radio and newspapers, it is amazing that one out of five consider it to be "most essential."

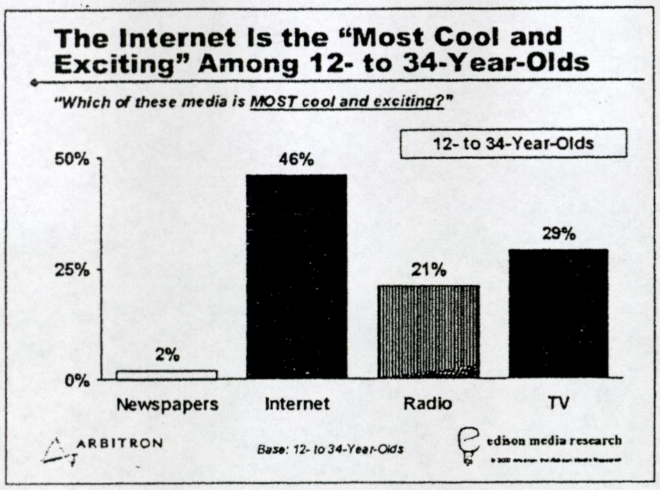


The greater the education level, the more essential the Internet is to consumers. Among those with a high school or less education, only 8% cite the Internet as "most essential," which increases to 30% among those with a four-year college degree or more.

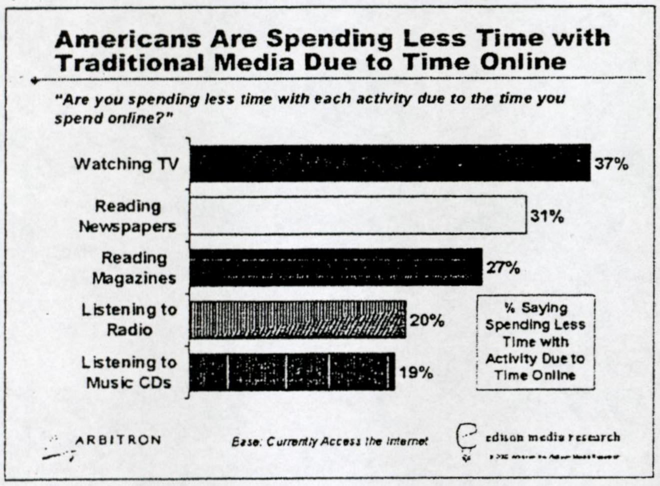


Among 12- to 24-year-olds, 34% see the Internet as "most essential" to their lives, slightly ahead of TV at 30% and radio at 27%. The Internet has rapidly become vital to the lives of younger consumers.

2. **The Internet is considered to be the "most cool and exciting" medium among 12- to 34-year-olds.** Consumers were asked to name the Internet, TV, radio or newspapers as the medium that is "most cool and exciting." The Internet was essentially tied with TV among all Americans (34% to 35%, respectively). However, among 12- to 34-year-olds the Internet dominates the "most cool and exciting" image (46%), well ahead of TV (29%) and radio (21%).



3. **Nearly four in ten online Americans indicate time spent online has resulted in less time watching TV.** Because of consumers' Internet use, 37% say they are watching TV less, followed by less time reading newspapers (31%), less time reading magazines (27%), less time listening to the radio (20%) and less time listening to music from CDs (19%).



4. **Nearly six in ten Americans say that radio is "getting better" lately, and over half say that TV is "getting worse."** Consumers were asked if radio, the Internet, newspapers and television were "getting better" or "getting worse" lately. Radio had the highest "getting better" score, while television had the most people saying that it is "getting worse."

% Who Say Medium Is Getting Better		% Who Say Medium Is Getting Worse	
Radio	59%	Television	52%
Internet	43%	Newspapers	23%
Newspapers	37%	Radio	19%
Television	33%	Internet	14%

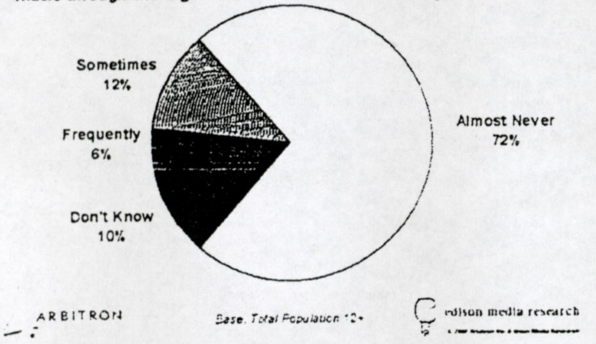
5. **Most Americans say that radio does a good job of providing the kinds of music, news and information they want.** Nearly three-quarters of Americans (74%) say that radio does a "good" or "very good job" of playing the kinds of music they like and seven in ten say that radio does a "good" or "very good job" of providing the news and information they want.

6. **Buying CDs from a store is the most frequent manner in which Americans access new music.** Consumers were asked to indicate the ways in which they access new music. Twenty-five percent indicate they "frequently" "buy CDs from a store," which is three times as many consumers who say they "copy CDs from friends and family" or "download MP3 files from the Internet" (8%). A smaller proportion indicates that they "frequently" "share MP3 files with friends and family" (6%) or access new music through "streaming audio over the Internet" (5%). Two percent say that they "buy CDs over the Internet."

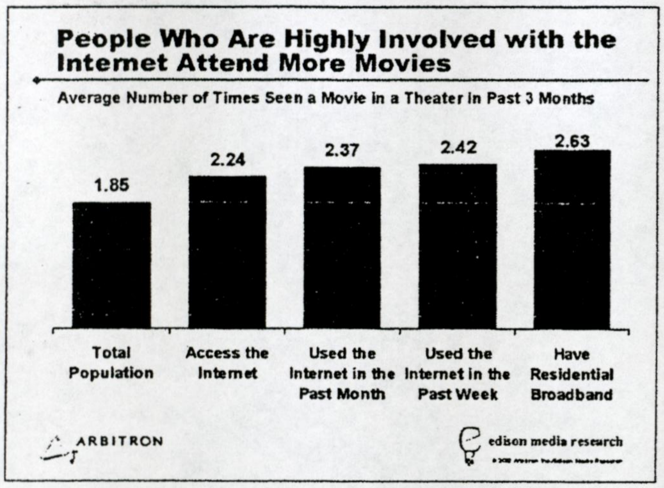
Despite the tremendous amount of publicity surrounding downloading and sharing of MP3 files, 72% of all Americans say they "almost never" download and share MP3 files from others.

Three-Quarters of Americans "Almost Never" Share MP3 Files

"Do you FREQUENTLY, SOMETIMES or ALMOST NEVER access new music through sharing MP3 files with friends and family?"

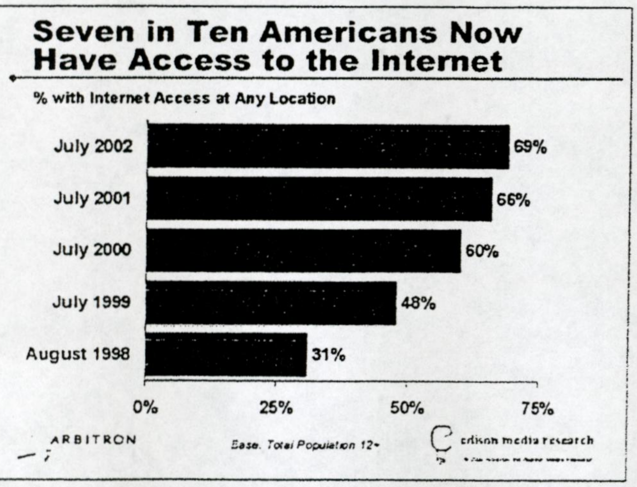


7. **Frequent users of the Internet are more likely to see movies.** On average, Americans have seen 1.85 movies in the past three months while 12- to 17-year-olds (3.61) and 18- to 24-year-olds (3.15) see nearly twice as many movies compared to the average. In addition, the more involved with the Internet, the more likely people are to see movies in theaters.



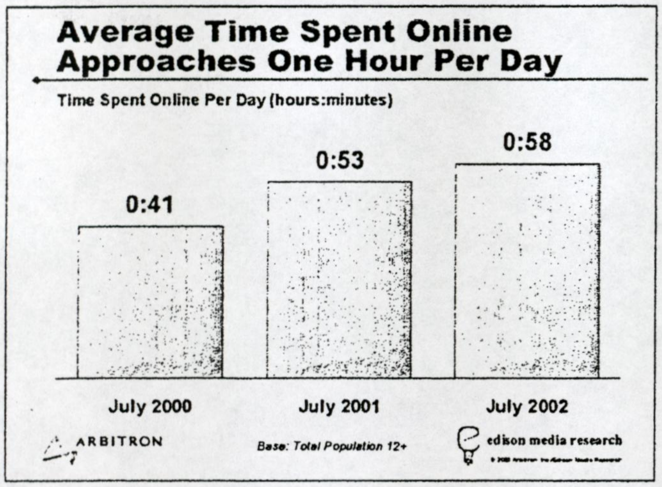
B. Internet Access Trends

8. **Access to the Internet has leveled off at approximately 70% of all Americans.** After years of rapid growth the proportion of those with access to the Internet has stabilized at seven out of ten Americans (69%). In August of 1998, 31% of Americans accessed the Internet at home or at work. One year later, nearly half of all Americans had Internet access at any location. In July of 2000, Internet access had reached 60%, and by summer of 2001 two-thirds of all Americans were accessing the Internet at any location. As of July 2002, 69% of all Americans now have access to the Internet.



9. **Six in ten Americans use the Internet each month and over half use it each week.** In July 2002 60% percent of Americans (87% of those online) used the Internet in the past 30 days, and 53% of Americans (78% of those online) used the Internet in the past week.

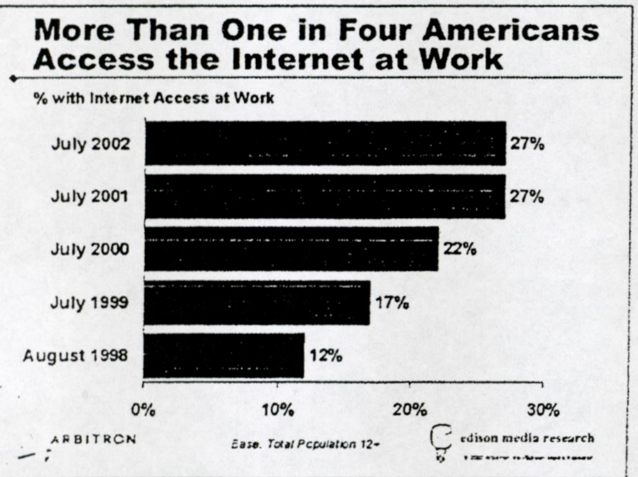
10. **Daily time spent online continues to rise.** While the growth of those with access to the Internet from any location has slowed, the average daily time spent online continues to climb. In July 2000, the average American reported spending 41 minutes online each day. In July 2002, Americans report an average of 58 minutes spent online per day.



11. **Seven in ten people live in households with a computer.** In August of 1998, 50% of Americans indicated that they had at least one computer in their home. As of July 2002, 69% now say they have a computer in their home.

12. **The number of people with access to the Internet at home is approaching the level of cable television**. Sixty-five percent of people in the U.S. live in homes that subscribe to cable television. Nearly six in ten (57%) Americans live in homes with access to the Internet.

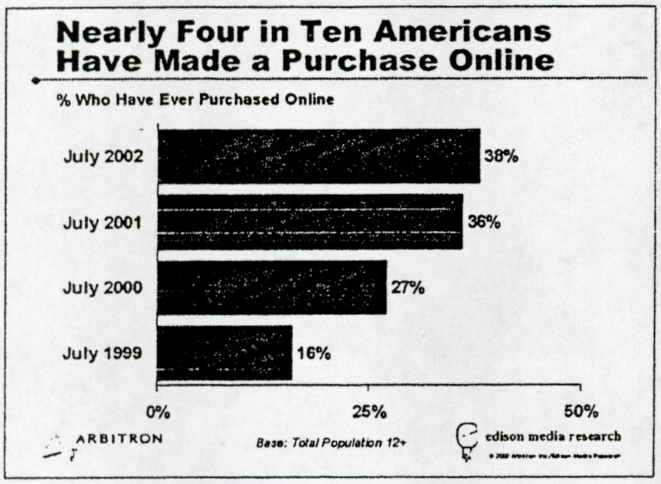
13. **More than one in four Americans have access to the Internet at work.** In August of 1998, only 12% of all Americans indicated they accessed the Internet at work. This number has increased substantially since that time. Currently, 27% of Americans access the Internet at work. Slightly less than half (46%) of those that work full or part time indicate they ever access the Internet at work.



14. **Music is the most frequent accompaniment to time spent online.** While using the Internet, 20% say they frequently listen to music CDs via a separate stereo or boom box (that is not part of their computer), 19% frequently listen to radio, and 17% frequently listen to CDs from the computer itself. Fifteen percent say they frequently talk on the telephone while surfing, and 13% frequently watch television while using the Internet.

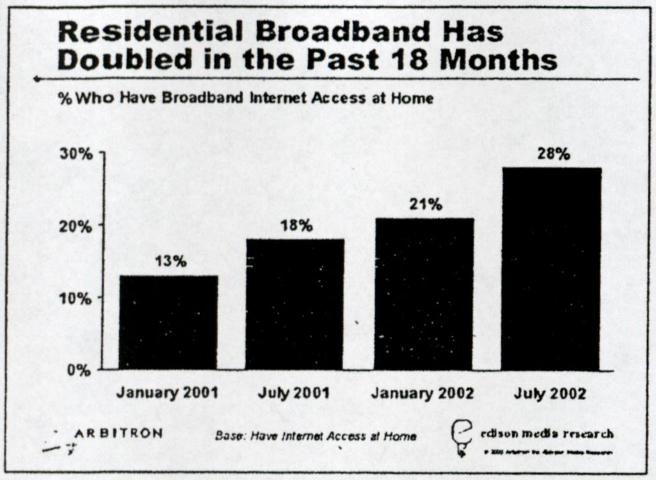
C. Buying Online

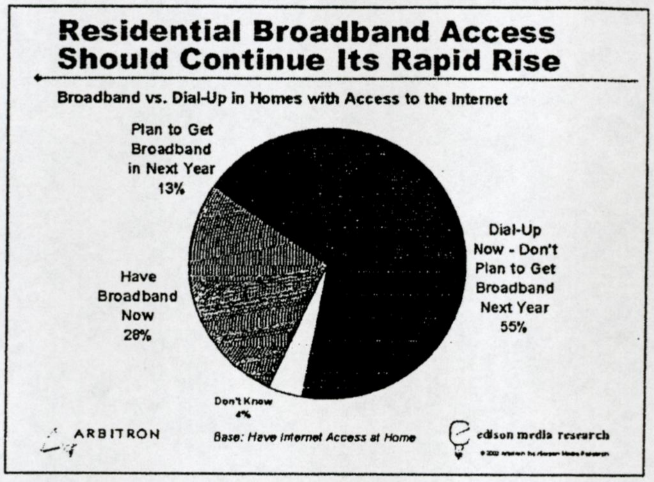
15. **The number of Americans who have made Internet purchases grew slightly, while online spending is down compared with one year ago.** In July 1999, only 16% of Americans had ever made a purchase from a Web site. By July 2001, the percentage of those who had ever made a purchase online more than doubled to 36%. Over the past year, there has been a slight increase in the number of people who have purchased online, rising to 38% in July 2002. Average spending online among those who made a purchase online in the last 12 months is $596, the lowest average annual online spending figure since we began measuring in January 2000, reflecting the slower economy.



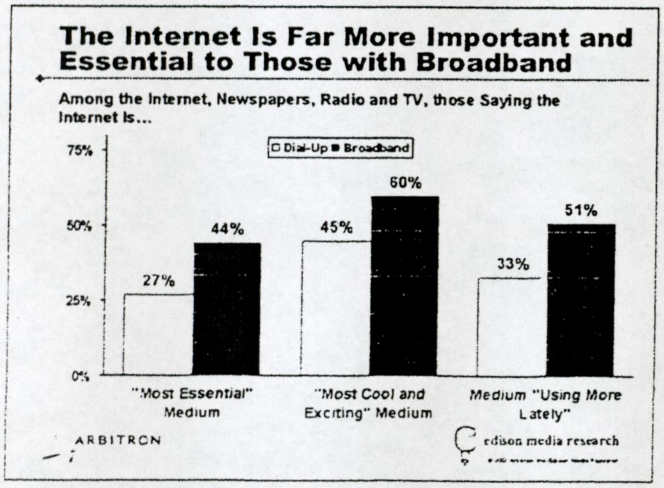
D. Broadband

16. **Residential broadband adoption has doubled in just under eighteen months.** In January 2001, 13% of those with Internet access at home indicated they access the Internet via a superfast, always-on broadband (cable modem or DSL) connection. Residential broadband access has increased sharply to 28% in July 2002. With the slowing economy, it is possible that broadband growth may not be as dramatic in the coming months. Yet, there appears to be continued interest in broadband adoption among consumers. In July 2002, 13% of those with dial-up access at home indicate their intention to get broadband in the coming year.





17. **Consumers who access the Internet via broadband indicate the Internet is far more important and essential in their life.** When asked to indicate which medium is "most essential in your life," 44% of those with broadband say the Internet, compared to 27% among those with dial-up access. When asked to indicate which medium is "most cool and exciting," those with broadband cite the Internet (60%) more often than those with dial-up (45%). In terms of perceived usage, 51% of those with broadband say they are "using the Internet more lately" compared with 33% of those with dial-up.



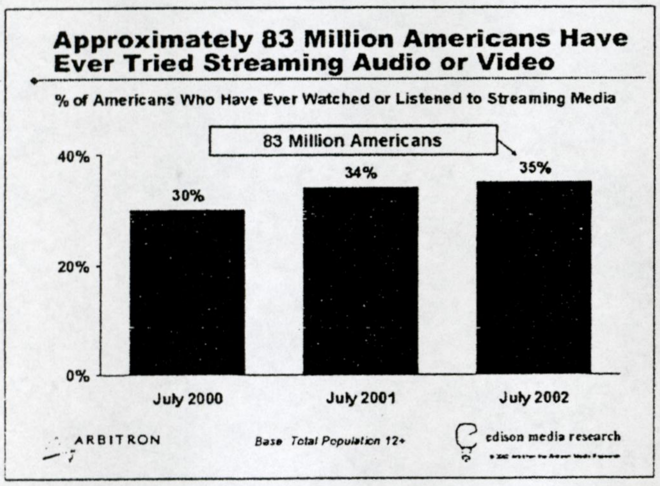
18. People with residential broadband Internet access spend nearly as much time online each day as they do with TV and radio.

Average Time Spent Per Day with Each Medium (Hours:Minutes)

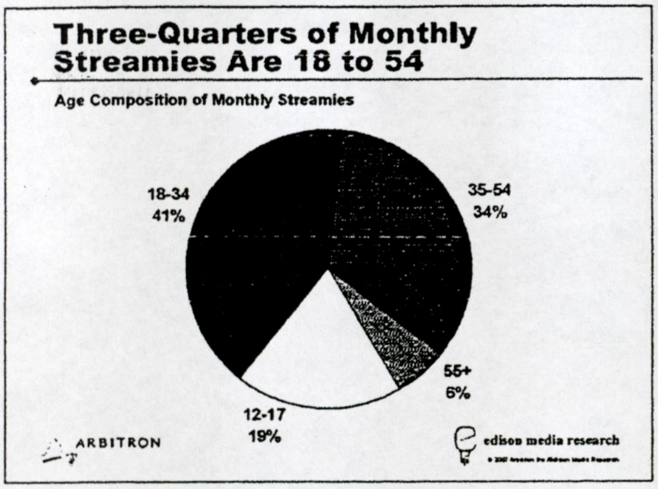
	Average Consumer	Those with Residential Broadband Internet Access
Watching Television	3:10	2:35
Listening to the Radio	2:43	2:19
On the Internet	:58	2:00
Reading Newspapers	:37	:35

E. Streaming Usage

19. An estimated 83 million Americans have ever tried streaming audio or video. As a percentage of the total population, 35% (approximately 83 million) indicate they have ever tried streaming. The number of Americans who have streamed in the last month (38 million – July 2002) is up slightly from the prior year (37 million – July 2001). The number of those who indicate that they have streamed in the past week has held steady at 19 million (July 2001 – July 2002).



20. **Three of four monthly Streamies are 18 to 54.** Seventy-five percent of monthly Streamies are 18 to 54 years of age. Forty-one percent are 18-34, 34% are 35-54, and 19% are teens (12-17). Only 6% are over the age of 55.

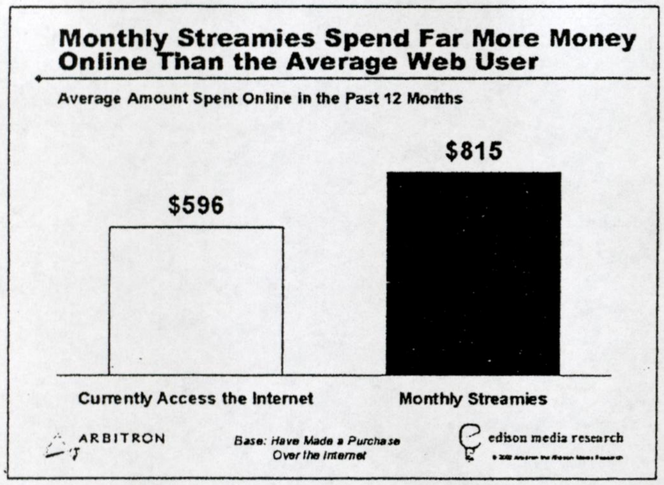


21. **Monthly Streamies are more Internet savvy and upscale than the total population.** Fifty-seven percent of monthly Streamies have a household income of $50K or more compared to 38% of the total population. Forty-five percent of monthly Streamies have a college degree or higher level of education compared with 32% among the total population. Regular Streamies are also far more likely to have residential broadband (39%) compared to Internet users in general (15%).

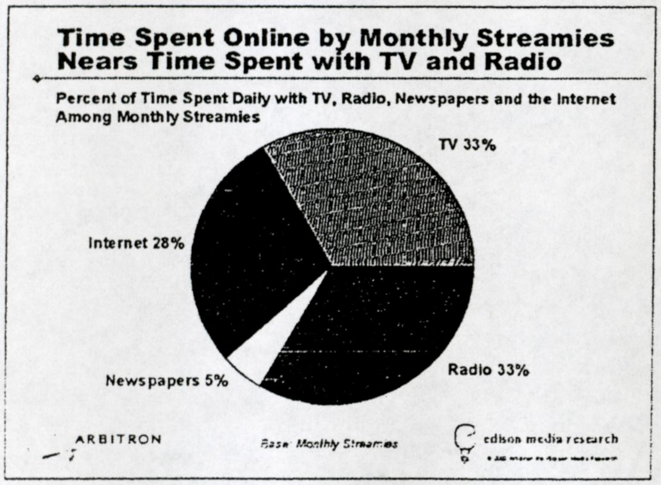
	Monthly Streamies	Total Population
$50,000+ annual household income	57%	38%
College graduate or higher level of education	45%	32%
Have residential broadband	39%	15%

Monthly Streamies also show more passion for the Internet as 46% say the Internet is "most essential" (compared with radio, TV and newspapers) vs. 28% for Web users in general. When asked to indicate if the Internet is getting better or worse lately, 72% of monthly Streamies say the Internet is "getting better" vs. 55% for the overall online population.

22. Consumers who regularly stream are more interactive than Web users overall. There is a stark contrast between those who have streamed audio or video in the past month and overall Web users. Streamies are more likely to respond to Internet advertising and make online purchases. Thirty percent of monthly Streamies have clicked Web advertising in the past month vs. 14% for Web users overall. Forty-three percent of monthly Streamies have made an online purchase in the past month vs. 25% for Web users overall. The total 12-month online expenditure is higher among monthly Streamies ($815) than online users as a whole ($596). In addition, monthly Streamies have purchased more CDs in the past year (18) compared to overall Web users (13).



23. Active Streamies spend nearly as much time online as they do with traditional media such as television or radio. Monthly Streamies spend a third of their time with television, a third with radio and 28% with the Internet.



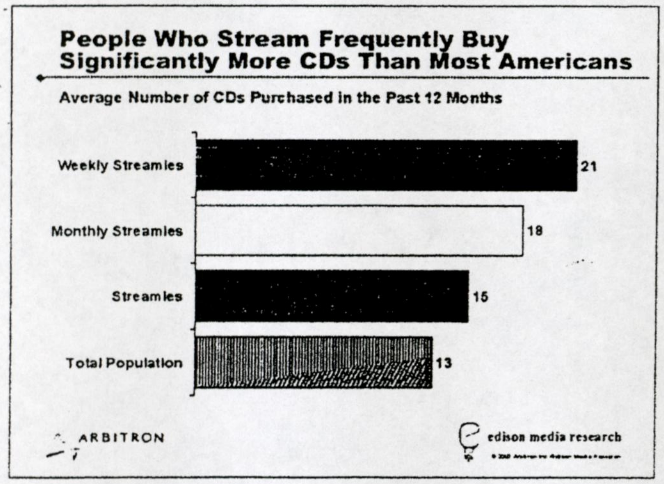
24. **People with residential broadband Internet access consume streaming media much more frequently than those with dial-up access.** Consumers who have superfast, always-on broadband connections in their homes are far more likely to have used streaming media on a monthly and weekly basis.

Percent Who Have Watched or Listened to Streaming Media...

Base: Currently Access the Internet at Home

	Broadband	Dial-Up
Ever	65%	52%
Monthly	37%	22%
Weekly	22%	9%

25. **People who stream frequently buy significantly more CDs than most Americans.** Some have mistakenly equated the rise of streaming audio with a decrease in record purchases. However, the data show that the more active Streamies (those streaming in the last month and last week) were also the group that purchased the greatest number of CDs in the past year. The average American purchased 13 CDs in the past year while those that have ever streamed have purchased 15 CDs. Monthly Streamies report that they bought an average of 18 CDs, and weekly Streamies say they have purchased nearly 21 CDs in the past year.



26. **People who stream each week see more movies than the general population.** On average, American consumers report having seen 1.85 movies at a movie theater in the past three months, which is significantly less than the 3.19 movies reported by weekly Streamies.

27. **Consumers appear to want instant gratification when it comes to streaming and show little interest in registration forms or downloading new media players.** Eighteen percent of Streamies say they would be "very likely" to download a new media player if it were required to access the site's Internet audio or video. Only 10% say they would be very likely to register with a site, by providing personal information, in order to stream. Fifty percent say they would be "not at all likely" to register with a site in order to listen or watch from that site.

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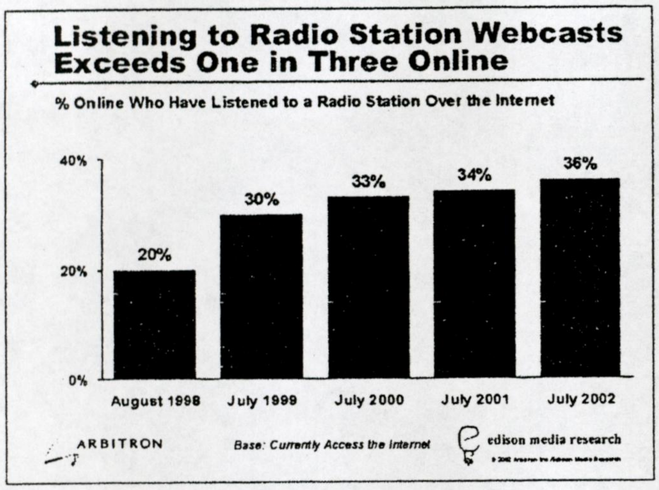
F. Internet Radio/Audio

28. **The number of consumers who have ever tried listening to radio stations online increased slightly in the past year while listening to radio station webcasts in the past week and past month is stable.** In summer 1998, 20% of those online had ever listened to radio stations over the Internet. As of July 2002, 36% have listened to radio stations online. The number of people who have listened to radio stations over the Internet in the last month (12%) and the last week (5%) remained steady during the past year.



29. **Audiences to Internet-only audio sources have decreased with fewer webcasts currently available.** While audiences to online radio stations are stable, the number of those who have tried to listen to online audio from Internet-only audio sources has decreased. The proportion of those online that say they have listened to Internet-only sources in the last month has decreased from 12% in July 2001 to 8% in 2002. A multitude of factors including digital rights, a slow advertising market and the soft economy have thinned the ranks of Internet-only webcasters. Therefore, it is not surprising that consumers report they are listening less frequently to these Internet-only webcasts.

30. **Unique content/variety, the "quality of audio," and "no commercials" are the factors that Streamies identify as "very important" when choosing a site to listen to Internet audio.**

Important Factors When Choosing a Site to Listen to Internet Audio

(Percent Providing a Score of 8 or Higher on a 10-Point Scale; "1" = Not At All Important, "10" = "Very Important")

You can listen to specific types of audio you are looking for	63%
The quality of the audio	59%
Having NO commercials during the webcast	57%
You can listen to a wide variety of audio	56%
You can listen to audio that you cannot get elsewhere	52%
Having noticeably few commercials during the webcast	52%
Having DJs and other personalities on the station or channel	22%

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31. **Half of weekly audio Streamies are aware of the controversy surrounding digital-rights fees.** Recently, the government imposed music licensing fees on webcasters that has resulted in the discontinuation of several webcasts. Forty-eight percent of weekly audio Streamies have heard about the situation, while 37% of all audio Streamies say they are aware of the issue surrounding government-imposed music licensing fees.

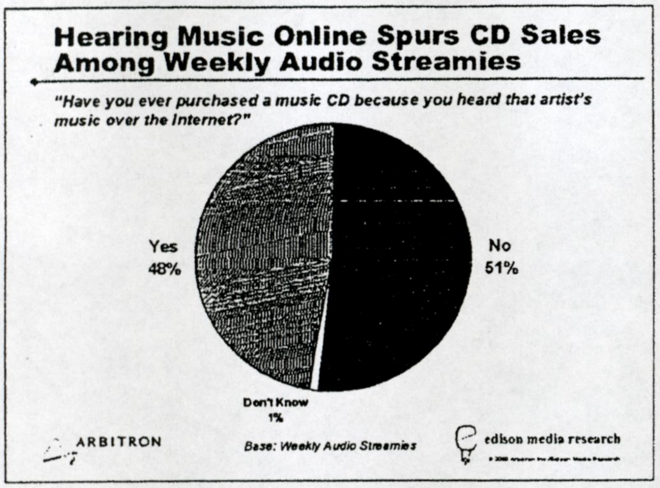
32. **Nearly two-thirds of monthly audio Streamies say they are upset over the loss of Internet audio webcasts due to digital-rights fees.** During the past several months there has been significant publicity regarding new digital-rights fees webcasters must pay to play music on the Internet. Sixty-two percent of those who have listened to Internet audio in the past month say they would be "very upset" or "somewhat upset" if they were no longer able to listen to the Internet audio webcasts they currently listen to due to these government-imposed fees. Nearly two-thirds (64%) of monthly Streamies support action by Congress to address these online music licensing fees in a way that would help Internet audio webcasters afford to continue streaming music.

33. **When it comes to listening to online radio stations, audio Streamies continue to favor local stations over those from other parts of the country.** Online radio listeners say they listen most often to local stations (48%) followed by stations from other parts of the U.S. (41%) and stations from other countries (8%).

    Younger listeners age 12-24 listen most often to local stations (59%) compared to stations from the rest of the U.S. (34%) while Streamies age 25-44 listen most to stations from other parts of the U.S. (46%) followed by local stations (42%). Older listeners have a greater likelihood of having lived in other parts of the country and therefore might be more interested in out-of-town stations than younger listeners. Consumers with broadband Internet access are much more interested in listening most to stations from around the U.S. while those with dial-up access favor local stations.

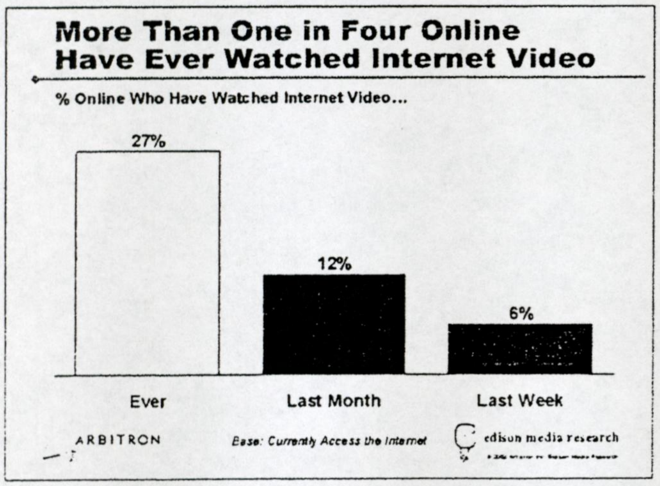
34. **Unique content is what drives American consumers to listen to Internet audio.** Six out of ten audio Streamies say they choose to listen to Internet audio because streaming provides content that they cannot find on local radio stations. A smaller proportion (23%) indicates that they listen to Internet audio because of difficulty in hearing local over-the-air radio signals.

35. **Half of weekly audio Streamies say that they have purchased a CD because they heard the artist's music over the Internet.** Forty-eight percent of those that have listened to online audio streaming over the past week have purchased a CD as a direct result of exposure to the artist's music over the Internet.



G. Internet Video

36. **More than one-quarter of those online have ever viewed video over the Internet**. Twenty-seven percent of those online have viewed video over the Internet, with 12% of those online having viewed Internet video in the last month and 6% having viewed video online in the past week.



37. Movie trailers and music videos are the leading types of content video Streamies say they have ever watched.

Top 10 Types of Content Among Video Streamies

% Who Have Ever Watched

Movie trailers or previews	62%
Music videos	52%
Online video weather forecasts	35%
Video newscasts	35%
Online video from TV stations	31%
Video highlights of sporting events	31%
Short or full-length movies	30%
Online video from TV stations from around the U.S.	23%
Online video business reports	12%
Online video from TV stations from local area	12%

38. One out of five monthly video Streamies are aware of the BMWfilms.com series of online "minimovies." One of the most acclaimed streaming video marketing campaigns involved BMW's use of well-known Hollywood directors to create compelling five-minute movies on the BMW Web site (www.bmwfilms.com) featuring BMW cars. It is impressive that such a large proportion of those who have consumed streaming video are aware of these films. Twenty-five percent of Internet users who use streaming video on a weekly basis are aware of this series, and 13% of those online have watched one or more of the online "minimovies." In total, approximately 3 million Streamies watched some of the BMWfilms.com series.

H. Major Internet/Streaming Brands

39. A huge number of Americans access the Internet via America Online. Overall, 30% of all Internet users subscribe to AOL. Twice as many Americans with dial-up Internet access subscribe to AOL (39%) as those with a broadband Internet connection at home (20%).

40. **None of the major Streaming media brands have established dominance in awareness, trial or regular usage.** There is a wide disparity in familiarity of the major streaming audio brands, with WindowsMedia.com and Yahoo Radio having the highest awareness among audio Streamies. Trial usage of the major streaming audio brands ranges from 10% to 37% of audio Streamies. On the whole, half of those who have ever listened to audio from any one of these brands indicate they have listened to that streaming brand in the past month.

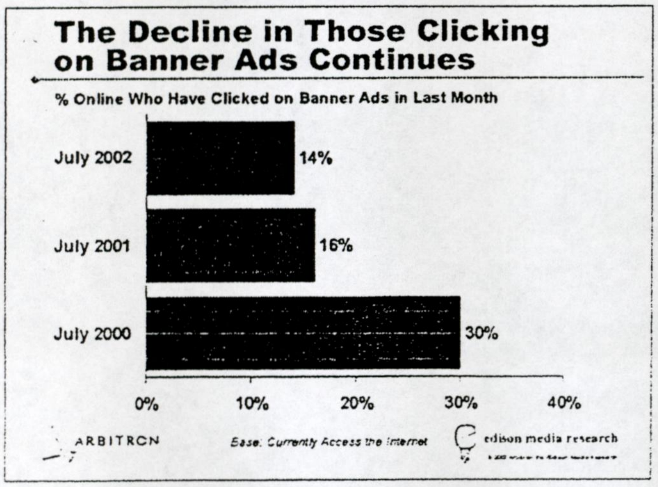
Listening to Major Streaming Audio Brands

Base: Audio Streamies

	% Familiar	% Ever Listened	% Listened Last Month	Monthly Usage as a % of Trial
WindowsMedia.com	59%	37%	17%	46%
Yahoo Radio	50%	26%	9%	35%
MSN Music	41%	21%	9%	43%
Radio@AOL	32%	19%	8%	42%
RealGuide.com	27%	16%	6%	38%
Launch.com	17%	10%	5%	50%

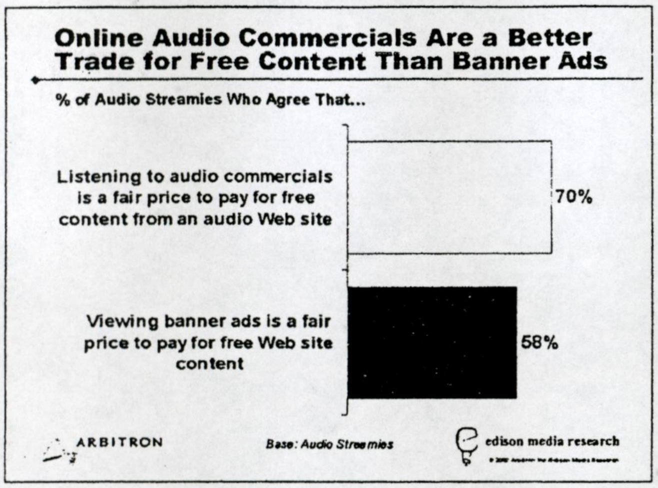
I. Subscription and Advertising

41. **The number of people online who click on Web site advertising continues to fall.** In 2000, the proportion of online consumers indicating that they had ever clicked on Web site advertising hit an all-time high of 50% before declining to 26% in July 2002. Those who clicked on any Web site advertising in the past month had dropped from 30% in July 2000 to 16% by summer 2001. As of July 2002, 14% of Internet users indicate they clicked on Web advertising in the last month.



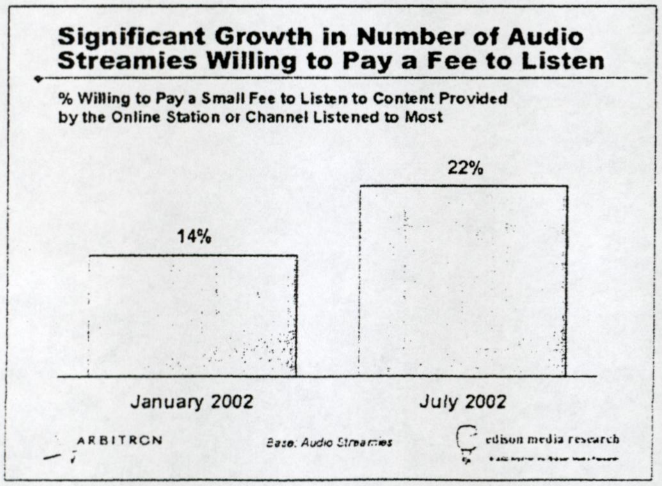
42. **Audio Streamies feel that online audio commercials are a better trade for free content than banner ads.** Fifty-eight percent of audio Streamies, and 45% of those online, agree that viewing Web site banner ads "is a fair price to pay for free content from a Web site." In a sign of possible

growing consumer irritation over Web site advertising, 30% and 35% disagree, respectively. A far higher number of audio Streamies indicate that listening to audio commercials is a fair price to pay (70%) for free Internet audio content.



43. Awareness of Internet audio advertising has grown steadily during the past year. In July 2001, 31% of audio Streamies had heard an audio commercial online. In July 2002, 40% had heard an online audio commercial. Two-thirds of weekly Streamies have heard an audio commercial while on the Internet while half of those that have listened online in the past month have heard an online audio commercial.

44. An estimated 16 million consumers say they would pay a subscription fee for their favorite audio webcast. There is growing acceptance among consumers to pay a subscription fee for online streaming content. Twenty-two percent of Internet audio Streamies (approximately 16 million consumers) say that they would be willing to pay a small fee to listen to the one audio channel they currently listen to the most over the Internet. Despite today's challenging economic climate, the proportion of audio Streamies who indicate their willingness to pay a subscription fee for online audio content has increased from 14% in January of 2002 to 22% in July 2002.



Those who stream more frequently are also more willing to pay a subscription fee than those who stream less frequently. Nearly one in three (30%) monthly audio Streamies say they would be willing to pay a subscription fee while 38% of weekly audio Streamies would be willing to do so.

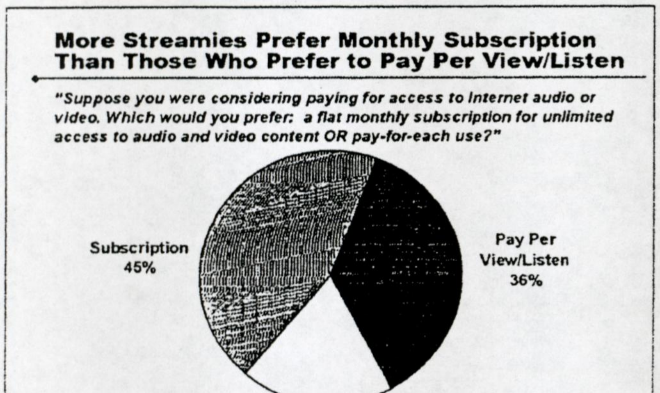
45. **The "HBO formula" of commercial-free compelling content with no commercials greatly enhances the value proposition of a streaming subscription model.** Forty-seven percent of audio Streamies say they would consider the idea of paying a small fee to listen to audio content if it offered unique programming they could not get elsewhere. Forty-two percent say they would consider streaming subscription concepts if there were no commercials and if the audio was of the highest quality.

Would Pay a Small Fee to Listen to Online Audio if...

Base: Audio Streamies

It offered content or programming you could not get elsewhere	47%
There were no commercials	42%
The audio was of the highest quality, without pausing or buffering	42%
There were noticeably fewer commercials	32%

46. **More Streamies say they prefer a monthly subscription fee than those who prefer a pay-per-view or pay-per-listen model.** Forty-five percent of Streamies say they prefer to pay a subscription fee for streaming content while 36% say they prefer a pay-per-view or pay-per-listen model. Female Streamies show equal interest in the two concepts while male Streamies tend to prefer a subscription model. Younger Streamies show a greater inclination to a flat monthly subscription model.



J. Local Media Web Sites and Marketing

47. **More online consumers rate the content of newspaper Web sites as "excellent" than radio and TV Web sites**. When asked to rate the content of newspaper, radio and TV Web sites they have visited, more online Americans said the content of newspaper sites is excellent (19%), followed by TV sites at 15% and radio station sites at 13%.

48. **Among the Web sites of major local media, newspapers have the highest trial usage, monthly visitation and conversion from trial into regular monthly visitation.** Compared with newspaper Web sites, TV Web sites have similar trial usage, monthly visitation and conversion of trial users into regular monthly visitors. Radio lags with significantly lower monthly visitation and conversion of trial into regular visitation.

Local Media Web Site Audience

Base: Currently Access the Internet

	Trial Usage	Monthly Visitation	Monthly Usage as a % of Trial
Newspapers	47%	26%	55%
TV	46%	22%	48%
Radio	41%	16%	39%

49. **More consumers recall having received e-mail from radio stations, but newspaper e-mail marketing is perceived to contain more useful information.** Twelve percent of those online recall having received an e-mail from a radio station, followed by 10% for newspapers and 6% for TV stations. When asked to rate the usefulness of the e-mail content, newspaper gets the highest marks (29% "very useful"). Seventeen percent rate TV station e-mail content as "very useful," and 15% rate radio station e-mail content as "very useful."

K. Satellite Radio

50. **Approximately 18 million Americans are "very interested" in satellite radio.** There is a strong correlation between interest in streaming media and satellite radio. Those who are "very interested" in satellite radio and audio Streamies are both highly interested in unique audio content not currently available over traditional radio. The greater the involvement with streaming, the greater the interest in satellite radio. While 8% of Americans overall indicate they are "very interested" in the satellite radio concept, 17% of weekly Streamies say they are "very interested" in satellite radio. In fact, 63% of Americans who say they are "very interested" in satellite radio have tried streaming. Therefore, streaming media is fertile ground for marketing and promoting satellite radio.

51. **Interest in satellite radio is strongest among men, younger consumers, Hispanics and African-Americans.** While 8% of Americans overall say they are "very interested" in satellite radio, African-Americans (14%) and Hispanics (12%) show greater interest in satellite radio. More men than woman are interested in satellite radio (10% "very interested" vs. 6% "very interested"). Consumers age 12-24 show greater interest (15%) than consumers age 25-54 (7%).

52. **In the past six months, XM Satellite Radio has doubled its level of awareness.** In January 2002, 17% of Americans indicated they had heard of the XM Satellite Radio service. In July 2002, 38% have now heard of XM. From January to July 2002, aided awareness for Sirius Satellite Radio increased from 8% to 11%. For both XM and Sirius, the level of awareness is twice as high among men as compared with women. Fifty-five percent of men in the U.S. are aware of XM compared to 23% of women. Sixteen percent of men are aware of Sirius compared to 7% of women.

Recommendations

1. **The streaming audience represents a huge opportunity for the recording industry.** While some in the record industry have viewed streaming as a threat, it is also an opportunity. This research shows that those who consume streaming media most frequently are also the same group that tends to buy more CDs. Streamies are far more interested in unique and compelling audio content and seek out online audio because it offers an alternative to traditional over-the-air radio. The vast majority of those who stream say they are doing so to be exposed to unique music they cannot get anywhere else. Ironically, the digital-rights fees being collected by the record labels are overwhelming the marketing channels the record company should be embracing. Actively advertising and marketing music on streaming media channels may be an important key to revenue growth for record labels.

2. **Subscription models represent a significant opportunity for streaming media.** An impressive 22% of audio Streamies indicate they would pay a small fee for the one audio channel they listen to the most. This translates into nearly 16 million potential streaming subscribers. The growth in consumer interest in subscription to content such as satellite radio and streaming media indicates an excellent subscription opportunity for business models involving unique and compelling audio content.

3. **The satellite radio and streaming media industries should work together because their consumers have common interests.** Satellite radio and streaming media have operated as totally separate business models. However, throughout this research, we see close parallels between those who are already streaming audio and video content over the Internet and those with a high degree of interest in satellite radio. In fact, 63% of all Americans who say they are "very interested" in satellite radio are those who have ever tried streaming audio or video over the Internet.

   Satellite radio companies should direct a portion of their marketing resources to advertising on streaming media. Advertising satellite radio on streaming media is like "shooting fish in a barrel." Streaming media has attracted an estimated 38 million monthly consumers who seek unique and compelling content. These are the very people that satellite radio seeks to convert into subscribers.

   There is also compelling streaming opportunity for satellite. Listeners to traditional radio stations can enjoy the content in their cars and at work. Currently, in-car listening represents 34% of all time spent with traditional radio in America. In addition, 26% of American radio time spent listening occurs at work. Satellite radio should explore opportunities to enable subscribers to take satellite radio to work with them. Satellite radio has an opportunity to promote its brand and generate revenue online by offering its content at work via streaming.

4. **Media and streaming companies should continue to develop partnerships to cater to and benefit from the growing residential broadband audience.** Nearly three in ten Americans have broadband Internet access at home, and those with broadband use streaming media much more frequently than those with dial-up access. Companies in both sectors stand to benefit from continued growth of the broadband audience, and should work together to cross-promote and provide incentives for consumers to both sign up for broadband at home and use streaming media.

5. **More than ever, streaming media needs to develop unique and compelling content of its own.** The key to growing the audience to streaming media is unique content. Significant cable audience growth occurred when unique content began to be developed. This unique content generated growth in cable television audiences and subsequent gains in its advertising revenue. Therefore, it is urgent for the streaming media industry to focus on developing "must see" and "must hear" content that will spur consumer awareness and passion.

6. **Webcasters need to organize their industry to create a simple mass reach advertising vehicle.** Each month, approximately 40 million Americans consume Internet audio and video webcasts. This audience is highly compelling and attractive for advertisers. Streamies are upscale, well educated, affluent, interactive and more likely to shop and buy online. The streaming media advertising industry needs to develop methods to reach a significant portion of that valuable audience easily and effectively. Whether this involves cooperation between the major streaming media players through common sales representative firms or industry organizations, standards need to be set and advertiser ease of use must be achieved. The "buying power of Streamies" is well documented. Now the industry needs to facilitate the advertising marketplace.

7. **Movie studios should use streaming media to advertise and promote their new films.** Weekly Streamies have seen significantly more movies in the past three months than most Americans. Plus, 62% of video Streamies report having viewed movie trailers or previews online, making trailers and previews the number one content for video Streamies. Therefore, movie studios should promote their new films (and retail videos) by including webcasting in their media mix.

Appendix A

The Current State of Streaming
July 2002

Streamies – Those who have ever listened or watched online

83 million Americans
35% of U.S. population 12+
51% of those online
32% have broadband Internet access at home

Monthly Streamies – Those who have listened or watched online in the last month

38 million Americans
16% of U.S. population 12+
23% of those online
39% have broadband Internet access at home

Weekly Streamies – Those who have listened or watched online in the last week

19 million Americans
8% of U.S. population 12+
12% of those online
48% have broadband Internet access at home

Appendix B

Profile of the U.S. Population, Internet Users and Streamies

	U.S. Population	Internet Users (69% of U.S. Population)	Total Streamies (35% of U.S. Population)	Last-Month Streamies (16% of U.S. Population)	Last-Week Streamies (8% of U.S. Population)
Demographics					
Men	47%*	48%	57%	62%	66%*
Women	53%	52%	43%	38%	34%
12-17	11%	14%	18%	19%	15%
18-24	11%	12%	15%	17%	20%
25-34	16%	17%	22%	24%	26%
35-44	19%	21%	21%	19%	21%
45-54	18%	20%	16%	15%	14%
55-64	12%	10%	6%	5%	4%
65+	13%	6%	2%	1%	1%
Employed part/full time	57%	65%	66%	67%	68%
Retired	16%	9%	5%	3%	2%
Student	12%	16%	19%	20%	22%
Homemaker	8%	6%	4%	3%	3%
Unemployed	5%	4%	5%	5%	4%
$50K+ HH income	38%	47%	52%	55%	57%
White	77%	76%	74%	73%	73%
African-American	8%	8%	8%	7%	7%
Hispanic/Latino	9%	8%	10%	11%	9%
Media time spent per day					
TV	3:10	2:53	2:56	2:52	2:46
Radio	2:43	2:40	2:44	2:53	2:50
Newspaper	:37	:34	:30	:28	:29
Internet	:58	1:19	1:50	2:25	2:44
Total media time spent	7:28	7:26	8:00	8:38	8:49

***How to read:** Forty-seven percent (47%) of the U.S. population age 12 and older are male vs. 66% of those who have streamed in the past week.

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Profile of the U.S. Population, Internet Users and Streamies (continued)

	U.S. Population	Internet Users *(69% of U.S. Population)*	Total Streamies *(35% of U.S. Population)*	Last-Month Streamies *(16% of U.S. Population)*	Last-Week Streamies *(8% of U.S. Population)*
Share of daily media time spent					
TV	43%	39%	37%	35%	31%
Radio	36%	36%	34%	34%	32%
Newspaper	8%	7%	6%	5%	6%
Internet	13%	18%	23%	28%	31%
% that say the Internet...					
is most cool and exciting	34%	45%	56%	64%	67%
is medium used to first learn about new music	11%	15%	22%	28%	33%
is medium using more lately	25%	33%	44%	57%	64%
has ads that allow you to quickly make a purchase	31%	40%	48%	51%	53%
At-home Internet connection					
Broadband	-	28%	32%	39%	48%
Dial-up	-	70%	66%	59%	51%
Plan to get broadband at home in next 12 months		19%	22%	25%	25%
Internet usage					
Used Internet in the last week	-	78%	89%	95%	98%
Weekly time spent online	-	8:23	11:05	14:05	16:25
Clicked on Web site advertising...					
ever	-	26%	37%	41%	46%
last month	-	14%	22%	30%	34%
last week	-	8%	12%	17%	23%

ARBITRON edison media research

Profile of the U.S. Population, Internet Users and Streamies (continued)

	U.S. Population	Internet Users *(69% of U.S. Population)*	Total Streamies *(35% of U.S. Population)*	Last-Month Streamies *(16% of U.S. Population)*	Last-Week Streamies *(8% of U.S. Population)*
Online buying habits					
Ever purchased online	-	55%	68%	74%	78%
Purchased online last month	-	25%	34%	43%	49%
Purchased online last week	-	11%	15%	21%	24%
Average amount spent online in last 12 months	-	$596	$677	$815	$882
Total CDs purchased in last 12 months	13.0	13.0	15.0	18.0	21.0
Total CDs purchased online in last 12 months	-	6.0	6.2	6.5	7.7
Streaming behavior					
Familiar with...					
Radio@AOL	-	21%	29%	33%	34%
MSN Music	-	30%	39%	44%	44%
Yahoo Radio	-	38%	47%	55%	57%
Real.com/RealGuide.com	-	16%	25%	31%	36%
Launch.com	-	11%	17%	23%	28%
WindowsMedia.com	-	43%	58%	65%	64%
Ever listened to...					
Radio@AOL	-	8%	16%	20%	18%
MSN Music	-	9%	18%	21%	21%
Yahoo Radio	-	11%	22%	28%	31%
Real.com/RealGuide.com	-	7%	13%	18%	20%
Launch.com	-	4%	8%	12%	14%
WindowsMedia.com	-	16%	31%	41%	42%

Profile of the U.S. Population, Internet Users and Streamies (continued)

	U.S. Population	Internet Users (69% of U.S. Population)	Total Streamies (35% of U.S. Population)	Last-Month Streamies (16% of U.S. Population)	Last-Week Streamies (8% of U.S. Population)
% willing to pay a small fee to listen to one audio channel listened to most over the Internet	-	-	22%	30%	38%
Heard audio commercial online	-	-	40%	52%	62%
Saw video commercial online	-	-	18%	21%	27%
Currently pay Web site subscription fees	-	1.7%	2.3%	3.9%	5.5%
Satellite radio					
Ever heard of XM Satellite Radio	38%	43%	57%	64%	63%
Ever heard of Sirius Satellite Radio	11%	12%	16%	18%	21%
% "very interested" in satellite radio	8%	10%	14%	16%	17%

Appendix C

Broadband vs. Dial-Up Connection Comparison

	People with Residential Broadband Access (16% of U.S. Population)	People with Dial-Up Home Internet Access (40% of U.S. Population)
Demographics		
Men	59%*	47%*
Women	41%	53%
12-17	17%	13%
18-24	13%	11%
25-34	15%	18%
35-44	20%	23%
45-54	22%	20%
55-64	9%	11%
65+	4%	6%
$50K+ HH income	59%	48%
Media time spent per day		
TV	2:35	2:47
Radio	2:19	2:43
Newspaper	:35	:35
Internet	2:00	1:17
Total media time spent	7:29	7:22
Share of daily media time spent		
TV	35%	37%
Radio	31%	37%
Newspaper	8%	8%
Internet	26%	18%
Weekly time spent online	11:37	8:25

***How to read:** Fifty-nine percent (59%) of those with broadband access at home are male vs. 47% of those with dial-up access.

Broadband vs. Dial-Up Connection Comparison (continued)

	People with Residential Broadband Access (16% of U.S. Population)	People with Dial-Up Home Internet Access (40% of U.S. Population)
% that say the Internet...		
is most cool and exciting	60%	45%
is medium used to first learn about new music	24%	14%
is medium using more lately	51%	33%
has advertisements that allow you to quickly make a purchase	47%	40%
Subscribe to cable TV	81%	65%
Subscribe to satellite TV	18%	22%
Average number of working PCs at home	2.0	1.5
Clicked on Web site advertising...		
ever	35%	26%
last month	21%	14%
last week	12%	8%
Online buying habits		
Ever purchased online	68%	58%
Purchased online last month	37%	27%
Purchased online last week	18%	10%
Average amount spent online in last 12 months	$825	$526

Broadband vs. Dial-Up Connection Comparison (continued)

	People with Residential Broadband Access (16% of U.S. Population)	People with Dial-Up Home Internet Access (40% of U.S. Population)
Online listening habits		
Listened to radio stations online last month	18%	12%
Listened to radio stations online last week	7%	5%
Have ever listened online to...		
music	62%	49%
MP3 files you have downloaded	48%	30%
radio stations	36%	31%
news reports	34%	25%
music that's not available from local radio	37%	26%
news and information you cannot get on local radio	34%	26%
radio stations in the U.S. but outside your local area	26%	19%
previously aired programming you want to hear again	25%	15%
sports play-by-play	16%	11%
the radio station you currently listen to most	16%	12%
radio stations from other countries	12%	7%
other radio stations in your local area	14%	11%
talk shows	9%	5%
Of radio stations normally listened to online, which listened to most...		
Radio stations from your local area	39%	51%
Radio stations from other parts of the U.S.	47%	40%
Radio stations from other countries	11%	6%

Broadband vs. Dial-Up Connection Comparison (continued)

	People with Residential Broadband Access (16% of U.S. Population)	People with Dial-Up Home Internet Access (40% of U.S. Population)
Listened to audio from Internet-only sources...		
ever	27%	18%
last month	14%	7%
last week	7%	3%
Online viewing habits		
Watched video over the Internet...		
ever	43%	24%
last month	23%	10%
last week	14%	4%
Online commercials		
Ever heard audio commercial online	43%	40%
Ever saw video commercial online	23%	15%
Satellite radio		
Ever heard of XM Satellite Radio	52%	42%
Ever heard of Sirius Satellite Radio	14%	12%
% "very interested" in satellite radio	11%	9%

About Arbitron Webcast Services

Arbitron has more than 50 years of leadership and experience in audience measurement. The company's Webcast Services division provides credible third-party measurement that advertisers and advertising agencies need in order to make informed media planning and buying decisions and webcasters need to demonstrate the size and value of their audience. Arbitron debuted the world's first webcast ratings in October 1999. Today, the company publishes Arbitron Webcast Ratings℠ every month, which include the top 75 measured stations and channels and the top 25 measured networks. Arbitron also has presented an overview of streaming media called "Webcasting 101" to more than 250 advertising agencies about the value of webcast advertising. All of Arbitron's studies can be found on the company's Web site at www.arbitron.com and can be downloaded free of charge.

About Edison Media Research

Edison Media Research conducts survey research and provides strategic information to radio stations, television stations, newspapers, cable networks, record labels, Internet companies and other media organizations. Edison Media Research has been cited by *Advertising Age* as the fastest growing company among their list of Top 100 market research companies in their past five annual listings. Edison Media Research works with many of the largest radio ownership groups, including Entercom, ABC Radio, Infinity, Emmis Communications and Westwood One, and also conducts strategic and perceptual research for a broad array of companies including AOL/Time Warner, CNN, Yahoo!, CBS, The Golf Channel, Court TV, Maverick Records, The Cleveland Cavaliers, Princeton University, Northwestern University, Sony Music, The Blackstone Group, Time-Life Music and the Voice of America. Edison Media Research also conducts research for successful radio stations in South America, Africa, Asia, Canada and Europe. All of Edison Media Research's industry studies can be found on the company's Web site at www.edisonresearch.com and can be downloaded free of charge.

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This exhibit is Restricted in its entirety and is therefore omitted from this Public version.

For Release: July 28, 2004

FTC Closes Investigation of Joint Venture Between Bertelsmann AG and Sony Corporation of America

The Federal Trade Commission today announced that it has closed its investigation into whether the proposed joint venture between Bertelsmann AG and Sony Corporation of America may substantially lessen competition in violation of Section 7 of the Clayton Act or Section 5 of the FTC Act.

The European Commission (EC) also reviewed this proposed merger. Throughout the course of their respective investigations, the FTC and the EC Competition Directorate's staff consulted and cooperated with each other under the terms of their 1991 cooperation agreement and 2002 Best Practices on Cooperation in Merger Investigations.

The Commission closed the investigation without taking any enforcement action. Both companies have been notified of the Commission's action. The closing letters sent by the FTC to the parties and a statement by Commissioner Mozelle W. Thompson have been posted on the Commission's Web site, and are the only publicly available documents regarding this action.

Copies of the closing letters are available from the FTC's Web site at http://www.ftc.gov and also from the FTC's Consumer Response Center, Room 130, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The FTC's Bureau of Competition seeks to prevent business practices that restrain competition. The Bureau carries out its mission by investigating alleged law violations and, when appropriate, recommending that the Commission take formal enforcement action. To notify the Bureau concerning particular business practices, call or write the Office of Policy and Evaluation, Room 394, Bureau of Competition, Federal Trade Commission, 600 Pennsylvania Ave, N.W., Washington, D.C. 20580, Electronic Mail: antitrust@ftc.gov; Telephone (202) 326-3300. For more information on the laws that the Bureau enforces, the Commission has published "Promoting Competition, Protecting Consumers: A Plain English Guide to Antitrust Laws," which can be accessed at http://www.ftc.gov/bc/compguide/index.htm.

MEDIA CONTACT:

Office of Public Affairs
202-326-2180

(FTC File No. 041-0054)

(http://www.ftc.gov/opa/2004/07/sonybmg.htm)

Related Documents:

- *The Proposed Joint Venture Between Sony Corporation of America and Bertelsmann AG*, FTC File No. 041-0054

Consumer Information:

- Protecting Consumers: A Plain English Guide to Antitrust Laws

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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Director
Bureau of Competition

Joseph Kattan, Esq.
Gibson, Dunn & Crutcher
1050 Connecticut Ave., N.W.
Washington, D.C. 20036-5306

Re: The proposed joint venture of Sony Corporation of America and Bertelsmann AG, FTC File No. 041-0054

Dear Mr. Kattan:

The Federal Trade Commission's Bureau of Competition has been conducting a nonpublic investigation to determine whether the proposed joint venture between Sony Corporation of America and Bertelsmann AG may violate Section 7 of the Clayton Act or Section 5 of the Federal Trade Commission Act.

Upon further review of this matter, it now appears that no additional action is warranted by the Commission at this time. Accordingly, pursuant to authority delegated by the Commission, the investigation has been closed. This action is not to be construed as a determination that a violation may not have occurred, just as the pendency of an investigation should not be construed as a determination that a violation has occurred. The Commission reserves the right to take such further action as the public interest may require.

Sincerely yours,

Bernard A. Nigro, Jr.
Deputy Director

SERV-D-X 67

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Director
Bureau of Competition

James F. Rill, Esq.
Howrey, Simon, Arnold & White
1299 Pennsylvania Ave., N.W.
Washington, D.C. 20004-2402

Re: The proposed joint venture of Sony Corporation of America and Bertelsmann AG, FTC File No. 041-0054

Dear Mr. Rill:

The Federal Trade Commission's Bureau of Competition has been conducting a nonpublic investigation to determine whether the proposed joint venture between Sony Corporation of America and Bertelsmann AG may violate Section 7 of the Clayton Act or Section 5 of the Federal Trade Commission Act.

Upon further review of this matter, it now appears that no additional action is warranted by the Commission at this time. Accordingly, pursuant to authority delegated by the Commission, the investigation has been closed. This action is not to be construed as a determination that a violation may not have occurred, just as the pendency of an investigation should not be construed as a determination that a violation has occurred. The Commission reserves the right to take such further action as the public interest may require.

Sincerely yours,

Bernard A. Nigro, Jr.
Deputy Director

SERV-D-X 68

STATEMENT OF COMMISSIONER MOZELLE W. THOMPSON

Sony Corporation of America/Bertelsmann Music Group Joint Venture, File No. 041-0054

The Commission today has closed its investigation into a proposed joint venture[1] between the Sony Corporation of America ("Sony") and Bertelsmann Music Group ("BMG") music labels. Although I concur in this determination, my decision was a difficult one, in part because I am particularly concerned about the impact of media mergers on the prices and quantity of media, as well as the diversity of content, available to consumers.

The history of facilitating practices in the music industry, coupled with the elimination of Sony and BMG as independent competitors, causes me concern. The music industry has been scrutinized closely in the past by the Commission in connection with proposed mergers[2] and with practices ranging from alleged anticompetitive Minimum Advertised Price ("MAP") programs[3] to agreements to fix prices and limit advertising.[4] The industry is highly concentrated among record labels, and the proposed joint venture will only enhance this concentration. Additionally, the history of parallel MAP policies in particular indicates a propensity for interdependent behavior among the major labels.

I acknowledge, however, that our investigation to date has not unearthed sufficient evidence on which to conclude with reasonable certainty that the proposed venture is likely to facilitate coordination in the relevant market in violation of the antitrust laws. Additionally, the evidence tends to show growing clout among retailers that may be enough to undermine a potential collective exercise of market power on the part of the major labels. For these reasons, I join the Commission's decision to close the investigation.

---

1 The venture excludes CD manufacturing, CD distribution, and music publishing.

2 See e.g., FTC v. Warner Communications, Inc., 742 F.2d 1156 (9th Cir.1984).

3 See e.g., Universal Music & Video Distribution Corp., Complaint in Docket No. C-3974 at ¶ 4 (May 10, 2000).

4 In the Matter of Polygram Holding, Inc. et al, ____F.T.C.___(July 23, 2003).

SERV-D-X 69

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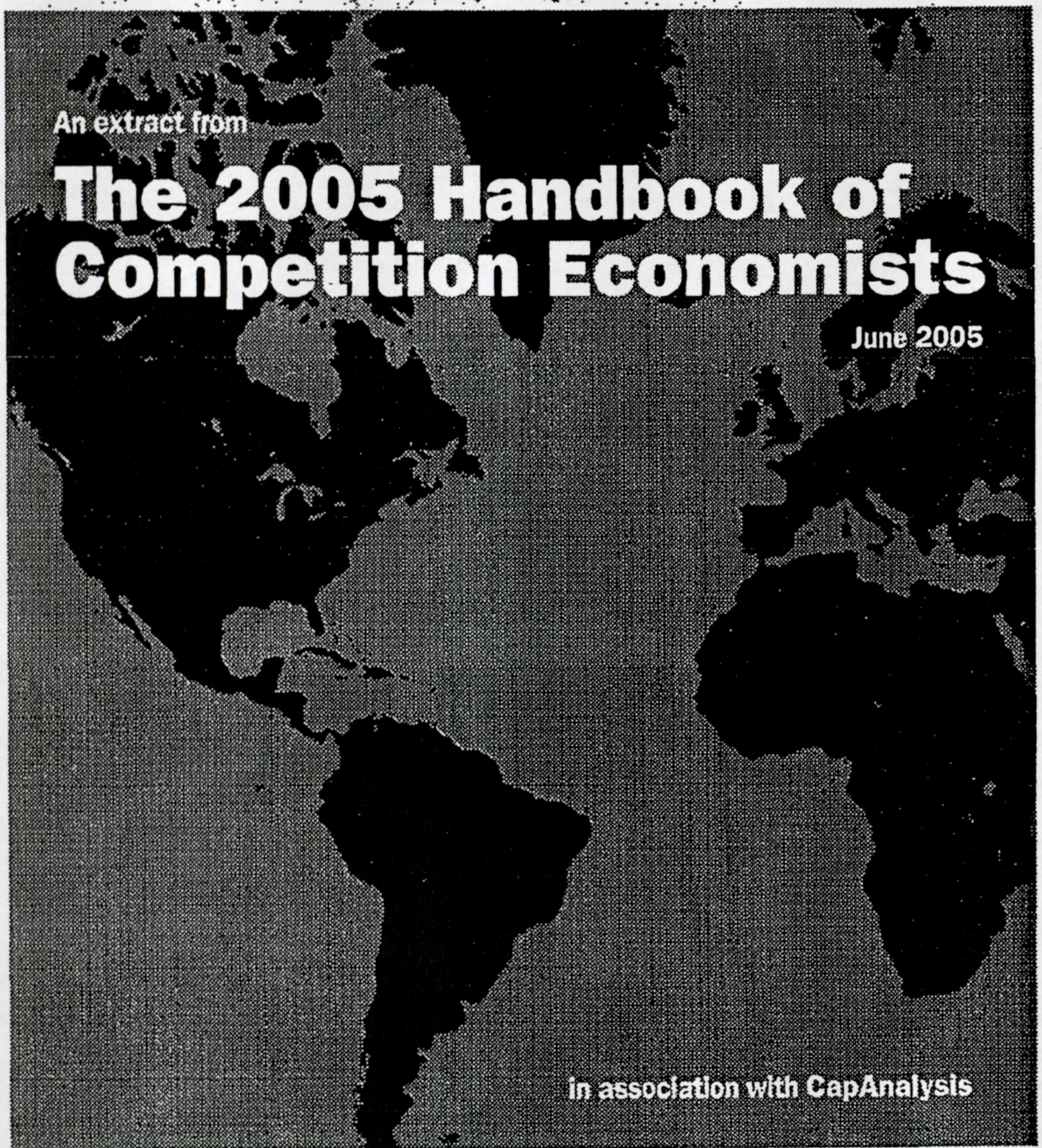
The international journal of competition policy and regulation



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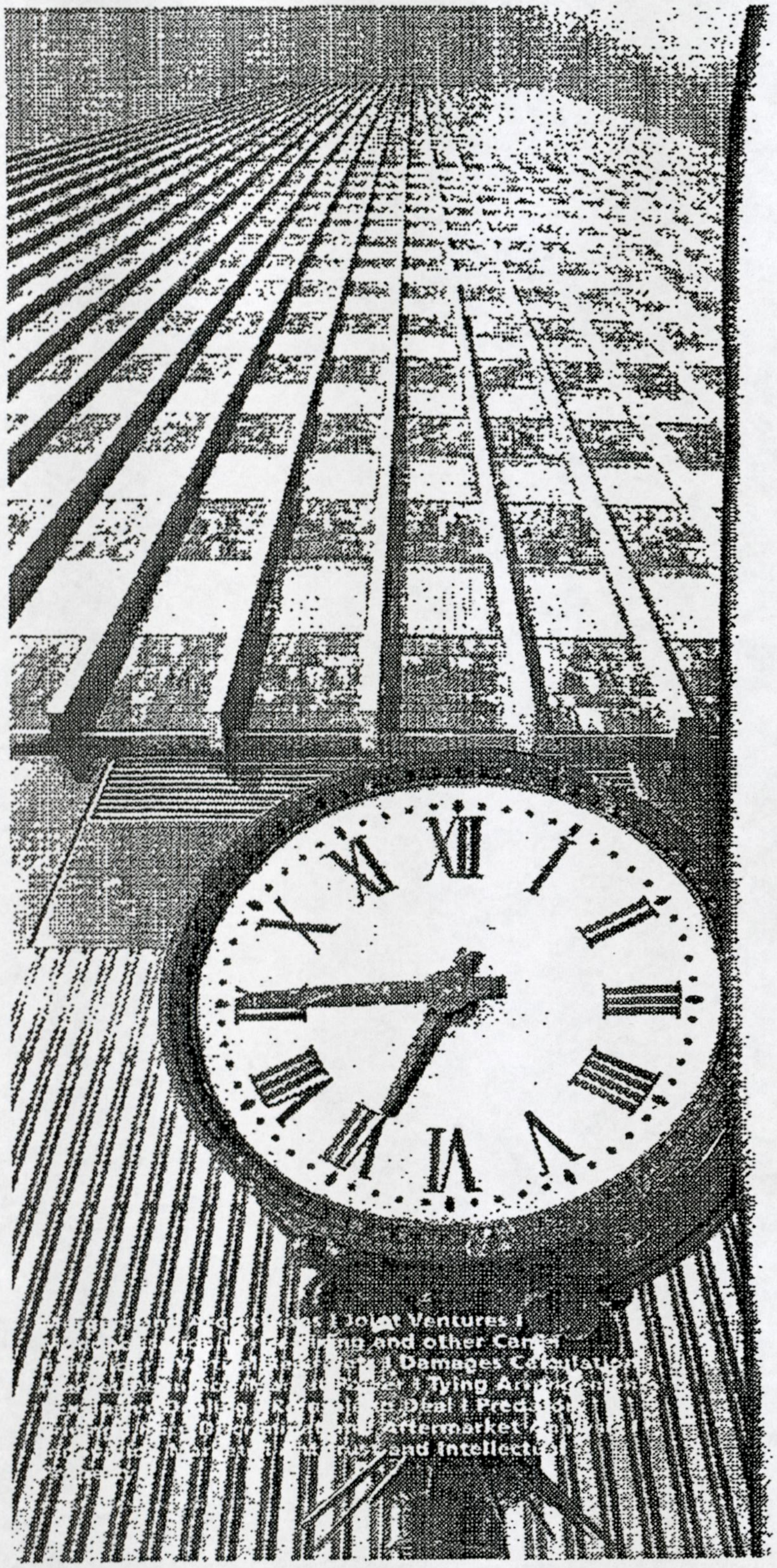

Mergers and Acquisitions

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Multijurisdictional merger control: relevant economic evidence

Susan Henley Manning and Eileen Reed*
CapAnalysis

The year 2004 was a landmark year for merger control in both the United States and the European Union. Both US agencies, the Department of Justice (DoJ) and the Federal Trade Commission (FTC), lost high-profile attempts in court to block two mergers, *US DoJ v Oracle Corp* and *FTC v Arch Coal*, whose reviews started in 2003. On 1 May 2004, the European Commission (the Commission) ushered in a revised merger reform framework (and general modernisation of its competition policy) and in December 2004 blocked one merger, EDP/GDP, an electric and gas utility combination in Portugal, but cleared two high-profile mergers that had already undergone full US scrutiny (Sony/BMG and Oracle/PeopleSoft). The prohibition of the EDP/GDP merger marked the first prohibition since 2001 when Mario Monti, the then EU competition commissioner, blocked two acquisitions, Schneider/Legrand and TetraLaval/Sidel, followed by both decisions being famously overturned by the Court of First Instance.

Economics played significant roles in all of these matters on both sides of the Atlantic. Judge Walker's opinion in the Oracle matter illustrates the importance of economic evidence in merger control.

"Despite the problems with qualitative analyses, modern econometric methods hold promise in analysing differentiated products unilateral effects cases. Merger simulation models may allow more precise estimations of likely competitive effects and eliminate the need to, or lessen the impact of, the arbitrariness inherent in defining the relevant market. For example, some merger simulation methods compensate for potential errors in market definition. A model advanced by Werden and Froeb uses a set of 'inside goods' and a set of 'outside goods'." (Id at 410, *United States of America, et al v Oracle Corporation*, N.Dist. Cal, No. C 04-0807 VRW at 45.)

As the Commission has adopted a more economics-based competition-merger policy with a refreshed look at its substantive tests, observers have speculated that this effects-based approach will contribute to more international enforcement convergence. Guidance from the Court of First Instance warns the Commission that sufficient economic evidence must support its decisions.

"Whilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission's interpretation of information of an economic nature. Not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it. Such a review is all the more necessary in the case of a prospective analysis required when examining a planned merger with conglomerate effect." (*Commission of the European Communities v Tetra Laval BV*, Case C-12/03 P, Judgment of the Court (Grand Chamber), 15 February 2005, at ¶ 39.)

An examination of the most recent parallel merger reviews by the US and the EU authorities provides a unique insight into the nature and extent of convergence between the interpretation of economic evidence and its effect on the enforcement outcomes in these two key jurisdictions. (See Best Practices on Cooperation in Merger Investigations, October 2002. Where the US and EU are reviewing the same transaction, "both jurisdictions have an interest in reaching, insofar as possible, consistent, or at least non-conflicting, outcomes." This joint statement is designed to promote "fully-informed decision-making on the part of both sides' authorities, to minimize the risk of divergent outcomes on both sides of the Atlantic, to facilitate coherence and compatibility in remedies, to enhance the efficiency of their respective investigations, to reduce burdens on merging parties and third parties, and to increase the overall transparency of the merger review processes.") This chapter focuses on two recent global mergers—Oracle/PeopleSoft and Sony/BMG—concluded in the past year that offer an opportunity to view the similarities and differences in the role played by, and the interpretation of, the economic evidence in the merger review process. It is noteworthy that both Sony/BMG and Oracle/PeopleSoft were technically reviewed under the EU's former merger control regulation, but a review of these matters indicates that great deference was given by the EU to the new Guidelines in evaluating the competitive effects of these transactions.

Oracle/PeopleSoft

Although the timing and procedural process of the parallel jurisdictional reviews were quite different, the Oracle/PeopleSoft merger review presents a good example of both the complexities and the investigational efficiencies that can result from such a joint review. An additional feature is that the US review process was ultimately concluded by an injunction trial whereas the EU process was concluded with an administrative decision. (Throughout the history of the ECMR, 19 out of more than 2,000 mergers have been blocked. Seven of these have been appealed— famously, three have been overturned by the CFI— four clearance decisions under the ECMR have been appealed by competitors.) Uniquely, the Commission decision incorporated many of the findings of the US trial court in its review, and endeavoured to maintain consistency between the two review processes.

Product market definition

In both jurisdictions, the definition of relevant markets continues to be a necessary starting point for the competitive assessment of mergers. It should be noted that the importance of market definition in unilateral effects differentiated products cases continues to be debated. The DoJ proposed that the rele-

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vant market consisted solely of high-function financial (FMS) and human resource management (HRM) enterprise resource planning software (ERP), sold by Oracle, PeopleSoft and SAP, (see Glueck and Manning. Economic Issues in Antitrust: 2003–2004, *The Antitrust Review of the Americas*, 2005 at 18–21) but presented no empirical economic evidence at trial to support this definition, relying instead on the testimony of customers and industry experts and the testimony of economic expert Kenneth Elzinga. With the burden of market definition squarely on the plaintiff DoJ, Judge Walker was unconvinced on the merits. In his opinion, customer testimony failed to address the key issue, "[b]ut the issue is not what solutions the customers would like or prefer for their data processing needs, the issue is what they could do in the event of an anti-competitive price increase by a post-merger Oracle." Walker found the testimony to be "speculative" on this issue and not supported by "serious analysis". Industry witnesses and system integrators were not found to be reliable or articulate on the market definition issue.

Judge Walker was even more direct on the need for economic analysis in his assessment of the testimony of Professor Iansiti, a professor of Business Administration at the Harvard Business School:

"Because of his [Iansiti's] lack of economic analysis and his inability to identify articulable product market boundaries (a key issue in a horizontal merger case), the court finds that Iansiti failed to establish a clearly defined product market along the lines alleged by plaintiffs." (*USA v Oracle* at 72.)

The DoJ's other expert, economist Kenneth Elzinga's evidence, was judged by Walker to be "circumstantial and highly qualitative" while relying on unreliable data (*USA v Oracle* at 125). Without any reliable supporting empirical economic evidence to the contrary, Judge Walker could not exclude other competing products and adopted Oracle's much broader market definition.

The EU's initial market investigation based on qualitative information led to the preliminary conclusion of separate markets for HRM and FMS high-function software for large corporations that could only be served by Oracle, PeopleSoft and SAP. After examining new bid data provided by Oracle and evidence presented at the US trial, the Commission concluded that other vendors had successfully won bids or had come in as the second choice or participated in the final bid rounds in other competitions. On the basis of these data, the EU concluded that at least four other vendors in addition to the 'Big 3' were market participants.

Geographic market definition

The geographic dimensions of the market differed—with the DoJ proposing a US market based on its expert's opinion, without economic empirical support, that marketing, installation, maintenance and provision of upgrades have inherently local aspects and that arbitrage between regions would be difficult. Oracle countered by producing empirical evidence showing that average discounts between Europe and the US were virtually identical (approximately 45 per cent) suggesting that European and US prices probably are constraints on each other.

Relying on the same average regional discount data presented by Oracle, the Commission concluded that the relevant geographic market was worldwide, as no specific barriers or other technical hurdles exist to limit suppliers from responding to large corporate bids worldwide, although it did allow that the relative strength or share of sales may vary by region. (The Commission did note in its decision that Oracle had originally argued in an oral hearing that the geographic market was EEA-wide, whereas in the US trial it argued that the geographic market was global.)

Theories of consumer-harm and anti-competitive effects

Under a mainly unilateral effects analysis, the DoJ complaint alleged that "the markets for high function HRM and FMS software are highly concentrated and the proposed purchase of PeopleSoft by Oracle would substantially increase concentration. The proposed purchase of PeopleSoft would reduce from three-to-two the number of firms that compete in the development and sale of these products." (See US DoJ First Amended Complaint, at 27.) In the course of its proceedings, the Commission argued that the transaction could lead to both unilateral effects and coordinated effects—where the three-to-two resulting duopoly could successfully coordinate, with no viable outsiders able to destabilise such a duopoly. Other theories of competitive harm were examined. The DoJ did not directly allege or present evidence at trial regarding coordinated effects, but did offer argument in a post-trial brief suggesting that it was plausible for a post-merger Oracle and SAP to tacitly collude to allocate markets along industry sectors. Similarly, the Commission considered possible vertical effects, but these were not determinative in its final decision.

The DoJ presented empirical economic analysis to support its position that the acquisition would result in higher prices for customers. Preston McAfee, the DoJ's economic expert, presented evidence on 25 specific competitions where the presence of PeopleSoft caused Oracle to offer greater discounts. Regression analysis confirmed these results. In addition, McAfee presented an auction model predicting higher post-acquisition prices. To counter these results, Oracle's expert Jerry Hausman took issue with McAfee's model specification, particularly the incremental discounts from list price calculations. Oracle also challenged the use of auction theory as the basis for the simulation model.

The benefit of additional bid data and the trial court deliberations allowed the Commission to conduct more robust econometric analyses demonstrating that the number and identity of the bidders did not systematically affect the discounts offered by Oracle. The Commission also used an auction model to simulate the effect of the merger, which allowed for uncertainty about the buyers' valuation of the alternative solutions. The model predicted not only substantial price increases due to the reduction

SX0008667

of bidders from three to two, but also tried to estimate the effect of the merger on consumer surplus. The Commission submits that the use of simulation models depends critically on the ability of the model to adequately capture the fundamental mechanisms that drive the behaviour of the different market participants. However, it maintains that such necessary simplifying assumptions are not fatal, as any economic model used in a prospective merger analysis is necessarily based on assumptions, and that models can provide a high degree of transparency of the underlying assumptions and logical consistency in the model framework. Therefore, the Commission maintains that merger simulation remains a useful tool.

In its final evaluation of the bidding data, the Commission determined that the absence of a significant, appreciable effect of the number and identity of the final round bidders in the bidding data regressions did not enable it to show anti-competitive effects from the merger. However, this result was not taken as proof that the merger would not have harmful effects on customers. In addition to these empirical results, the Commission based its decision on the broader set of competitor and customer questionnaire responses, and the large body of documentary and US trial court evidence.

The US court found that the DoJ had failed to establish that the merged firm could exercise market power and thus, that the merger would not substantially lessen competition. The Commission also cleared the Oracle/PeopleSoft merger without conditions. A systematic review of the development of the economic evidence developed by the Commission suggests that although it benefited from the parallel US investigation, it conducted an independent merger investigation appropriately reflective of the EU market context.

Sony/BMG

In January 2004, Sony and Bertelsmann notified the competition authorities of their plan to create a full-function joint venture (SonyBMG) for their global recorded music business. This merger was investigated by both the US and EU, but resulted in much less transparency about the parallel processes than in the Oracle/PeopleSoft case described above. The FTC opened an investigation in 2004, but produced no published account of its reasoning or proceedings before closing its inquiry without taking any enforcement action.

In its initial review, the Commission solicited responses from customers and other competitors and provisionally concluded that the national markets for recorded music are dominated by five global record companies (the so-called 'majors') including Sony Music, BMG, Universal Music Group, Warner Music Group and EMI, which jointly have market shares between 72 per cent and 93 per cent in the European Economic Area (EEA) countries. Universal is the largest player and the combined SonyBMG is of approximately equal size.

Based on this initial investigation, the Commission issued a Statement of Objections and requested detailed transactions data from the five majors going back several years from all EEA markets. The empirical analysis and interpretation of this economic evidence formed the basis of its ultimate decision to allow the joint venture to proceed.

The focus of the Commission's investigation was the effect of the joint venture on the market for recorded music, which constitutes the largest part of the decision, but the decision also dealt with effects on upstream and downstream markets (music publishing and online distribution), on which SonyBMG would not be active itself but which could be affected by the joint venture.

Product market definition

The Commission chose a broad approach towards the product market definition and decided that the relevant market for recorded music in general was the appropriate market within which to evaluate this transaction, without seeing a need to define narrower markets based on genres or categories of recorded music (such as singles, albums or compilations). The Commission did not follow the parties' arguments that the online distribution of music was part of the market for recorded music but instead found the markets for the distribution of physical media and the online distribution of music to be distinct markets. Among the reasons for this distinction was that online music sales were characterised by different demand, namely for individual tracks (songs) and not for entire albums, and differences in the control that suppliers have over the use of the product after it is purchased by the consumer (the so-called digital rights management for online music). On the supply side, online and physical distribution of music were found to be entirely different. The Commission furthermore defined two separate markets for the wholesale licensing to online music services and the retail distribution from online music services to final consumers. Due to characteristics of the licensing structure, both markets were found to be national. The Commission defined the publishing of music (requiring mainly mechanical and performance rights for the distribution of music) as being an upstream market for the distribution of recorded and online music. Music publishing involves the authors and composers of music, whereas the recording business involves the singers and musicians. The Commission left the question open whether there could be separate markets for music publishing based on different types of rights and whether the geographic scope was national or wider.

Theories of consumer-harm anti-competitive effects

In its focus on the market for recorded music, the Commission's competitive impact analysis was based on a coordinated effects theory focused on the possible strengthening of a collective dominant position of the five major record companies maintained by tacit collusion. The Commission had requested from the five majors large amounts of price and sales data for several years for all EEA markets; its analysis was however somewhat focused on the five largest countries, as the smaller countries showed a similar picture. (The Commission also examined a possible vertical foreclosure theory that Sony/BMG could foreclose competitors if Bertelsmann refused to let them advertise and promote their

SX0008668

artists on TV and radio. The Commission found no evidence that the foreclosure of rival record companies would have been a profitable strategy for Bertelsmann.)

The Commission analysed whether the pricing data revealed a coordinated pricing policy among the majors. For that purpose, a subset of the data limited to the sales of the top 100 single album CDs (as opposed to single CDs, maxi CDs and albums with more than one CD) to the top 20 customers was used to compare average net wholesale prices between majors. The parties have criticised the Commission for using average prices, arguing that these could be affected by mere product mix changes. The Commission furthermore regarded the focus on the top 100 albums to be justified by the fact that these covered 70 per cent to 80 per cent of the major's total music sales and were thus considered representative.

The Commission examined three key metrics: (1) parallelism in average net prices; (2) likelihood of using list prices (published prices to dealers or PPDs) as focal points to coordinate net prices; and (3) whether the majors' discounts to significant customers were aligned and sufficiently transparent to be monitored by each other.

In all of the five countries, the Commission economists found that there was some degree of parallelism in the pattern of average net prices between the five majors. The price differences between the majors generally were found to be confined within a relatively narrow band.

An empirical economic analysis revealed that list prices were potential focal points, as the differences between the various PPDs of different majors were relatively close to one another and, even though each major had a high number of different list prices, a very small number of these accounted for the vast majority of sales. These prices were also found to be transparent as they can be gathered from the majors' catalogues.

The Commission did not find significant differences on the overall discount levels between Sony and BMG. On the individual customer level however, differences between the discounts granted by the two merging parties were found to be large enough to let the Commission conclude that there was no sufficient alignment in the discounts to establish existing coordinated behaviour.

The Commission went on to analyse whether the markets were characterised by features that made them conducive to collusion. Although the physical characteristics of CD albums and the way they are marketed are relatively homogeneous, their content was found to be rather heterogeneous, which makes tacit collusion more difficult.

The Commission acknowledged that the variety of list prices complicated monitoring, while at the same time finding that monitoring only a limited set of albums (the top 20 selling albums of each major) would allow the record companies to assess the pricing for about half of the total sales. The publication of weekly hit charts including sales of each album, the limited number of large customers and the frequent contacts between all majors' sales personnel and the wholesalers/retailers were found to be facilitating collusion. However, the difficulties in monitoring certain types of discounts were found to be substantial and no evidence could be established that the record companies had solved this coordination problem.

Next, the Commission investigated whether retaliation against deviators was feasible and whether evidence of past retaliation could be found. Three potential mechanisms were identified: (1) a return to competitive behaviour; (2) exclusion of a deviator from compilations; and (3) retaliation in different markets (publishing and online). However, no evidence could be established that any of these methods had been used in the past to punish a deviator or that explicit threats in that direction had been made.

Although the Commission contended that some degree of pricing parallelism had been found, no conclusive evidence could be established regarding the existence of a collective dominant position of the five majors in any of the EEA countries.

The market for online distribution of music is relatively recent and still small. The Commission found that the majors had a similar or even stronger position in the market for wholesale licences for online music than in the market for recorded music. Prices charged for licences to online music providers were in a limited range but different usage rights made a comparison difficult. The Commission found that the prices charged to online music providers did not reflect the cost savings that could be achieved in comparison to the distribution of physical music recordings, but concluded that there was not sufficient evidence for a finding of existing collective dominance or that collective dominance was likely to be created by the joint venture.

For these reasons, the Commission cleared the merger on 19 July 2004, without conditions or obligations. Impala, an organisation of several independent music companies, has recently challenged the clearance decision of the Commission before the CFI (Pending case T-464/04, see OJ C 096, 1 August 2005, p 46).

In the US, the FTC closed its investigation on 28 July 2004, nine days after the Commission decided to clear the joint venture. The parties presented empirical evidence on the distribution of wholesale pricing, price dispersion for same release, and an econometric analysis showing that wholesale prices could not be reliably predicted from retail price. An econometric analysis also was presented showing no causation between consolidation in the industry and higher prices. In a press release, the FTC stated that: "Throughout the course of their respective investigations, the FTC and the Commission Competition Directorate's staff consulted and cooperated with each other under the terms of their 1991 cooperation agreement and 2002 statement of Best Practices on Cooperation in Merger Investigations." Details concerning this cooperation are unfortunately not known.

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SX0008669

SX0008670

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Dr Manning has performed economic analysis for antitrust litigation involving monopolisation, attempted monopolisation, vertical restraints, tortious interference, and fraud. She has also provided estimated lost profit and restitution damages for plaintiffs and defendants in antitrust, going-concern, breach of contract disputes, Lanham Act trademark and false advertising disputes, and intellectual property litigation.

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At the Federal Trade Commission, she conducted analyses of the energy industry contributing to several publications concerning oil industry mergers and pipeline ownership issues. She also participated in pre-merger reviews and merger investigations and has designed research and analytical approaches, undertaken budgeting, monitored progress and prepared testimony and affidavits on economic and public policy issues.

Ms Reed has helped European clients participate and expand in US and European markets and has advised in the area of antitrust policy and compliance. She assisted in several European merger reviews both before the European Commission and national competition authorities including the recent UK Phase II investigation conducted by the Competition Commission into Carl Zeiss/Bio-Rad Laboratories, which resulted in an unconditional clearance.

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